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No. 87-1245

In The

Supreme Court of the United States

October Term, 1987

TEXAS MONTHLY, INC.,

Appellant,

vs.

BOB BULLOCK, Comptroller of Public Accounts of the State of Texas, JIM MATTOX, Attorney General of the State of Texas, and ANN RICHARDS, Treasurer of the State of Texas,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS THIRD SUPREME JUDICIAL DISTRICT OF TEXAS, AT AUSTIN

JOINT APPENDIX VOLUME II

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	)	
VS.	)	
	)	
STATE OF TEXAS, BOB	)	
BULLOCK, COMPTROLLER	)	JUDICIAL
OF PUBLIC ACCOUNTS OF	)	DISTRICT
THE STATE OF TEXAS,	)	
JIM MATTOX, ATTORNEY	)	
GENERAL OF THE STATE	)	
OF TEXAS, AND ANN	)	TRAVIS
RICHARDS, TREASURER OF	)	COUNTY,
THE STATE OF TEXAS	)	TEXAS

STATEMENT OF FACTS

VOLUME TWO

BEFORE THE HONORABLE JOE B. DIBRELL, JR.

APPEARANCES

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(p. 2) BE IT REMEMBERED, that on the 3rd, 4th and 5th days of February, A.D. 1986, the above numbered and entitled cause came on for hearing before the HONORABLE JOE B. DIBRELL, JR.

WHEREUPON the following evidence was given and proceedings were had, to-wit:

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(p. 5) (Before the commencement of the proceedings, instruments were marked as Plaintiff's Exhibits Nos. 49 and 50 for identification.)

RICHARD L. LEPERE

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please, sir?

A. Richard L. Lepere, 1607 New Hampshire Avenue Northwest, Washington D.C. 20009.

Q. Mr. Lepere, what's your business or occupation?

A. I'm an advisor to a number of publishing companies and financial institutions in the United States.

Q. Okay. Does your business include consulting with the management and publishers of magazines?

A. Primarily magazine publishers. I deal with them in a wide variety of areas (p. 6) including marketing analysis, marketing plans, financial analysis, evaluations, research, acquisition of divestitures.

Q. Can you tell the Court whether or not you perform consulting and advisory services regarding circulation programs?

A. I do indeed. That was my background—circulation and finance. It could range from developing a circulation plan for a new magazine to changing the strategy of a mature magazine.

Q. Could you tell the Court your professional background—what your work history has been?

A. Prior to forming my own firm in 1975, I worked for *U.S. News & World Report* as a marketing manager. I worked for *Psychology Today* as a circulation director, the latter being headquartered in Del Mar, California at the time, the—or excuse me—*U.S. News* being headquartered in Washington, *Psychology Today* being headquartered in Del Mar, California.

Q. Okay, and who are some of the companies that you perform work for currently in the magazine business?

A. The Washington Post Company, the (p. 7) owner of *Newsweek*, CBS, *The National Law Journal*—something familiar to you gentlemen—Morgan Stanley.

Q. What business—does CBS have a magazine business?

A. CBS has a half a billion dollar magazine division.

Q. What kind of magazines do they publish?

A. Oh, they publish *Woman's Day*. They publish *Road & Track*. They publish *Yachting*. They publish *Car & Driver*. They publish *Field & Stream* and a host of others. I just don't recall them off the top of my head.

Q. All right. What kind of work would you do for a banking company or a financial institution like Morgan Stanley?

A. My last asignment with Morgan Stanley was an acquisition analysis of the Law Journal Press, which is the publisher of *The New York Law Journal*, a daily newspaper, and *The National Law Journal*, a weekly newspaper covering the legal profession. It was acquired by Price Communications from Scott Foresman & Company,

and I was hired to determine whether (p. 8) the proposed price being offered for it was fair and reasonable to the buyers and if they could anticipate a reasonable rate of return on it.

Q. Did you—during the course of your business, are you familiar with and involved with the economics of valuing magazine properties for purchase or sale?

A. I do quite a bit of that.

Q. If you can, tell the Court the ones that you—transactions that have been concluded. What transactions have you been involved with that might be familiar to the Court?

A. I represented the group who were the underbidders in the *U.S. News & World Report* transaction.

Q. When was that?

A. Oh, that was in 1983, 1984. It was an acquisition that finally traded about a hundred and sixty-eight million dollars. I was involved in the acquisition of Law Journal Press, another client of mine, in December of '85. We closed the acquisition of *Mother Earth News*.

Q. In these transactions are part of your job the analysis of the magazine's (p. 9) operation and its valuing as a business?

A. That's correct. There are, however, other forms of evaluation. Many of my clients are privately held. We have to do evaluations for estate purposes, tax purposes, transfer of stock purposes to minors, and preparing market values of companies can take many, many forms.

Q. Okay. I have had the court reporter mark a list of your company's clients. Can you identify that, please?

A. Yes, sir.

Q. Is Plaintiff's Exhibit 50—is that a current list of the companies you've worked for and represented over the last few years?

A. Yes. It is not quite current. I could add a few more to it, if you like.

Q. If you know, can you tell the Court other companies that you've done work for?

A. Mutual Benefit Life Insurance Company is the most recent one.

Q. Is that in connection with the magazine industry?

A. Yes.

Q. What kind of work would you have done for them?

(p. 10) A. They are investigating the possibility of developing a communications division as part of their investment portfolio, and I have been retained to develop the list of possibilities for them.

Q. All right. Any others?

A. No, that's the major one.

Q. Okay. Now, in connection with your work—

MR. GEORGE: Well, first of all, I'll offer Exhibit 50.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. In connection with your work, have you had an occasion to become familiar with the method by which nationally circulated magazines or magazines generally are printed and the services to the subscribers—fulfillment services are rendered?

A. Yes, I have.

Q. Okay, and can you tell the Court what the circumstances are how you became familiar with that?

A. Well, for the past ten or 11 years I (p. 11) have been retained by 50 or 60 companies again to help them start new magazines, develop mature magazines. I have also been in the business of doing it myself. I am intimately familiar with the financial and operating problems of perhaps a hundred and fifty to 200 different magazines.

Q. Okay, and that's part of your regular business?

A. Yes.

Q. Okay. Now, can you tell the Court whether or not it is commonplace to have magazines printed in areas or places in which they're not marketed, such as *Texas Monthly* is printed in Tennessee and shipped down to Texas. Is that a common type transaction?

A. It's quite common. Printing and distribution is a function of really cost. There are a number of printers who have various configuration of presses, for instance, and *Time Magazine*, for instance, can't print its 4 million copies a week at one magazine—at one printer and ship it from one point because they wouldn't have enough time to close the magazine, get it printed, closing being wrap it up, have all of the stories in them. They wouldn't have

(p. 12) the time to close it and mail it and deliver it to customers on a reasonable timely basis. So they print at four or five printing locations across the country.

THE COURT: Well, are you saying—we may have an objection.

MR. MENDEZ: I've got an objection to his testifying about *Time Magazine* because I'm going through this list, and I don't see them on here as one of his clients.

THE COURT: *Time/Life Books.* I don't know, but that's maybe—

MR. MENDEZ: Well, I'd like to ask him before he goes on—

THE COURT: All right.

MR. MENDEZ: —is that how he found out this information before he goes on about that.

THE COURT: All right.

THE WITNESS: It's common practice. I'm familiar with it—

VOIR DIRE EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. How are you familiar with it, sir?

(p. 13) A. Because *U.S. News & World Report,* which is a client of mine, owns a company called Publisher's Service, Incorporated, which picks up all of the *Time* copy—copy for *Time Magazine* and transmits it to the various printers across the country. It's done electronically.

Q. And did you examine these records yourself, sir?

A. I was attempting to buy the company. I examined them very closely.

Q. Okay, and is that how you familiarized yourself with how *Time Magazine* might operate?

A. Yes, in addition to my general knowledge of how the business operates.

MR. MENDEZ: I'll withdraw my objection.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. GEORGE:

Q. Mr. Lepere, would you please continue to describe how *Time* would deliver its—

A. If *Time* upsets anybody, we can pick on *Newsweek* and *U.S. News & World Report,* which (p. 14) also deliver the copies of the magazine the same way. They will print at four or five or six, seven printing locations across the country, and the real reason is again it's a function of cost and timely delivery. They want to close their magazine and the story selection and put them into print at the latest possible date in the week, which is typically early Saturday morning. They want to print it and get it distributed so it's delivered in the majority by Monday, Tuesday of the following week, and that's just impossible to do trying to print in one location. So they will print in five or six. It is not an uncommon practice. *Newsweek,* of course, is located in New York City, and I don't believe they have a printer in New York City.

Q. Do you know whether any of those companies have printers in Texas?

A. I don't know that as fact. I don't believe so. I don't believe so.

Q. Now, do they—are you familiar with how they get the magazines that are printed around the country to post offices for placing in the postal services?

A. The postal rates for magazines is a (p. 15) somewhat complex procedure. There is what is called the single piece rate, which the post office charges for any magazine that enters the system, and then there's the per pound rate for editorial material, and they take the weight of the magazine and take the editorial material, and there's a rate for that regardless of where it goes in the country, and then there's another rate—per pound rate for advertising, which is zoned. For instance, if you're in Connecticut and you have a subscriber in California, it's being sent to zone eight, which is the most expensive zone—again the reason for the regional printing. *Newsweek* will print its West Coast subscriber copies most likely in Los Angeles to cut down on the postal rate for advertising poundage.

Q. Do they truck the magazines after printing to post offices—

A. Yes.

Q. —where they can be mailed?

A. Yes, or some of the larger printers have postal facilities right in their shop. The big R.R. Donnelley plants, the Krieger plants will have a postal facility as part of the (p. 16) printing production process.

Q. Okay, and from your knowledge of these—the big companies you've talked about, do they mail, for example, *Newsweek* and *Time* and *U.S. News & World Report*—

those kinds of companies mail their products all from New York?

A. No. No, it's simply impossible to do that.

Q. Do they mail them from all over the country?

A. They will mail them from—

THE COURT: Just a question. Do they have regional advertising, too, that's different?

THE WITNESS: Not necessarily. They all carry regional advertising editions, Your Honor, but it's more—for instance, the smaller—the big three news magazines—*U.S. News & World Report* would have fewer regional editions, and those regional editions would cover a larger territory than, for instance, *Time Magazine,* which has double the circulation and can make regions smaller for advertising purposes.

QUESTIONS BY MR. GEORGE:

(p. 17) Q. But it is true that *Time* would have advertising pages in a copy sent to Texas that it would not have in advertising pages sent to Utah?

A. That's true, but it's—again *Time Magazine* can have smaller regions because their circulation is four and a half million, where *U.S. News* would have a larger region because the circulation is two million.

Q. But each of them have regional editions?

A. Yes.

Q. Okay, and in terms of other magazines that are not in the *Newsweek* weekly kind of magazine that you

may be involved with, do they print them at one location, truck them to another and deliver them to the postal service, as well?

A. Again it's a function of printing press configuration—what kind of presses they have. There's *Architectual Digest* which—or Knapp Communications, which produces *Architectural Digest, Bon Appetit* and *Home Magazine. Architectural Digest* is 600,000 circulation. Knapp Communications is located in (p. 18) Los Angeles, but they print in Wisconsin. Okay, and they print in Wisconsin because it's a center section of the country, and so their postal rates are at its most modest point, and where they have big circulation going into a specific geographic area, such as Los Angeles, they will truck the copies to Los Angeles.

Q. And then mail them from there?

A. Mail them from the local L.A. entry point, as it's called, or they'll ship them to Atlanta, or they'll ship them to New York.

Q. All right. Now, in connection with—are you familiar with *Texas Monthly's* way of printing its magazine and getting it delivered to the postal service?

A. Generally, yes, I am.

Q. And you, I believe, were involved early on in the life of *Texas Monthly,* weren't you?

A. I was indeed.

Q. Can you tell the Court a little bit about your early involvement as a consultant with *Texas Monthly?*

A. I think I became involved with *Texas Monthly* in 19—late 1973 or 1974.

(p. 19) Q. That was the year it was—year after it began?

A. Yes. Yes, sir, when it was, as I finally referred to it, four guys sitting on orange crates trying to put out a magazine, and I assisted *Texas Monthly* in the development of their circulation planning and marketing, which in the early days was what was paying the bills. I guess the other area I became deeply involved in was just budgeting for the company.

Q. And your continued involvement lasted for—on a regular basis—

A. Eight.

Q. —for ten years or eight?

A. Eight, nine years.

Q. Now, and you're familiar today with—are you familiar today with the way the company operates generally?

A. Yes.

Q. Okay. Now, in connection with at least the physical system of printing and delivering magazines, does *Texas Monthly* in your opinion operate similarly to the other 50 or a hundred magazines that you've worked for?

MR. MENDEZ: I'm going to (p. 20) object before he answers that question because I want—I think that he's not qualified to answer that, at least as of the time I deposed him last week. He hasn't talked to these people for several years, except for about a two-minute conversation that he had last week, and I want to know how he became so familiar with today's—

THE COURT: You'll be able to bring that out on cross examination—the credibility of it. I don't see where it precludes his testimony.

MR. MENDEZ: It's going to. He's about to make an opinion about how they're operating today, and all I know is that he talked to them two minutes last week about what they're doing today.

THE COURT: All right. Well, I'm going to overrule the objection.

THE WITNESS: You know, I'm—as a practical matter, I have a number of friends at *Texas Monthly* who I consider personal friends, Mr. Gerhart being one of them, and from time to time we chat about any number of subjects, some very non-specific, some very specific, where I can be helpful, and while my (p. 21) day-to-day involvement with the company ceased about two years ago, I guess we've stayed in touch and just sort of idle chitchat. I know they're printing up in, I guess, Nashville. They're a very good printer. I presume it is a function of cost and delivery time.

QUESTIONS BY MR. GEORGE:

Q. Now, is their operation, as you're familiar with it, the same or substantially the same in mechanism, that is, the way it works, the way it's delivered, as other magazines that are delivered into Texas who are headquartered in Los Angeles or New York?

A. Sure. I'll use *Architectural Digest* as the example. They're headquartered in Los Angeles. They're printed in Wisconsin, and they're delivered to the State

of Texas, and my guess is, Jim; although, I can't tell you this positively, that they must have enough circulation in the State of Texas to truck it down here to make it worthwhile to truck it down.

Q. Okay, and that's commonly trucked into Texas for mailing to Texas of magazines such as this?

A. Sure. It's an entry point. I think (p. 22) Dallas is your main entry point in the State of Texas, if I remember my postal charts correctly.

Q. Okay. Now, can you tell the Court how magazines generally go about maintaining or building their circulation—the kinds of methods to acquire circulation that exists?

A. Well, you—you have this marvelous invention called direct mail or junk mail, as it's sometimes referred to, which tends to be the primary source for magazines. It tends to provide the greatest volume of orders for magazines. You then use space ads in other magazines, free-standing inserts in newspapers, agents—either direct mail agents, such as Publishers Clearinghouse, or American Family Publishers is the other large one.

Q. Those are the people that give away the 10 million dollars?

A. 10 million dollars, that's right.

Q. Ed McMahon gives away on TV?

A. That's right. It started out a long time ago with two houses or your dream house or something. It's escalated with inflation. They will—

Q. Do all publishers use those same (p. 23) kind of agents?

A. I beg your pardon?

Q. Do all of the publishers that you're familiar with use those essentially?

A. There are a very few publishers who don't. They tend to be the exception.

Q. All right, and you were mentioning—are there other kinds of agents—direct solicitation agents?

A. There are field agents. There's school agents. There's catalog agents. Field agents tend to sell door to door. School agents tend to be the children who go to their uncle two blocks away and say, "Please, Uncle Tom, buy a magazine subscription so we can get new football uniforms for the school." There are catalog agencies, which tend to sell to school districts—to libraries primarily. It's not students selling to parents or uncles. It's selling copies into the library itself.

Q. Now, in connection with these direct sales agents—the people who go door to door, either by school children or by otherwise—other kind of agents, such as people who claim to be working their way through college or other (p. 24) folks who come through to houses selling magazine subscriptions, do those agents take—solicit orders for the magazine?

A. Yes, they do.

Q. Is that the way they work? Can you explain to the Court how that system works, in terms of orders being

taken by these people and remitting them to the publisher and what happens?

A. Well, *Reader's Digest* is the owner of a company called Quality School plan, which tends to be the largest of what is referred to as the school agents. The fellow who used to be in charge of it—and I think he still is—is Bill Nielson. They organize regional—it's sort of like a pyramid. They organize regional people, their employees, to negotiate with the school systems, school districts or sometime individual schools to enter into an agreement where the school organizes the students to sell magazine subscriptions, and it's all the types of magazine subscriptions—not *Texas Monthly* or *Time* or *Newsweek*. I would imagine there's a hundred or so publications in there. They, in turn, arm the students with your little pamphlet and order forms. They go out and knock on doors. (p. 25) Be it their uncle or aunt or their dad or their mother, they sell the subscription. They collect the money. They turn it back over to the person at the school who organizes it, and they get shipped back ultimately to Reader's Digest Quality School Plan, who then disburses the orders out to the publishers.

Q. Now, are these people soliciting the orders for the publishers? They're not selling—they're not buying magazines and reselling them, are they?

A. No, they're not.

Q. Okay. They're soliciting orders?

A. Yes.

Q. Okay, and in your experience, you mentioned that you were—done work and involved with a hundred maga-

zines over your career in this country. Can you name any of them that—well, can you name some for the Court that use school plans? It may be easier ones that don't use school plans.

A. Yeah, mostly it would be easier that way. *The National Law Journal* does not use school plans. They—98 percent of them use the school plans. It's a very rare magazine (p. 26) that does not.

Q. Okay, and have you become familiar with the way that school plans operate through dealing with the school plans themselves?

A. In—when they first started, I think I was one of their first customers when I was at *U.S. World News & Report* as an employee, and yes, I became familiar with it.

Q. Okay. Are there other school plans, besides the *Readers' Digest* one?

A. *Reader's Digest* brought out one of the large ones, which was—I think it was called Sunland School Plans and there is now—TV Guide is the other major producer, and it brought out a—another service called Perfect Subscription School Plans, which used to be owned by Curtis Publishing.

Q. Okay. Now, in connection with the economics of these school agents—these people coming into—these representatives that are soliciting orders, do—who gets the majority of the money in those circumstances?

A. The Quality School Plan gets the majority of the money. The typical arrangement would be 15 or 20 cents on the dollar going to (p. 27) the publisher, the balance

going to Quality School Plan, who, in turn, has arrangements to pay various school districts and the schools so they can get their band uniforms or football uniforms or whatever the case may be that they're trying to acquire.

Q. Okay. Now, in connection with this sort of arrangement, why would a publisher pay out 80 to 90 percent of the total revenue from a subscription to a soliciting agent as commission?

A. For a number of reasons. One, of course, is to maintain your advertising rate base, which is the contract you have with advertisers to deliver a certain number of copies a month. The other and primary reason is for a publisher—while we tend to care what new orders cost us, we look at all of our other sources and try to do what's economically best, but our real money is—comes in from the renewal of that order, and if we can get—out of a hundred school orders coming in where we only collect ten or 15 or 20 percent of the revenue, when we renew them—45 or 50 of them—a year later, we keep it all.

Q. Okay, and the renewal is the price?

(p. 28) A. That's the price.

Q. Now, in connection with your work, have you become familiar with efforts by magazines over the years to try to collect in those—well, first of all, in those jurisdictions that have a sales tax or some other incremental fee, to collect taxes from subscribers through mail subscribers?

A. It's simply not done.

Q. Okay, and can you tell—have you seen some of your clients try to do it—operate in a way to see what happened?

A. There have been a number of things that have been tried, some not specifically related to sales tax but related to other things, and I can go back to the days where I was an employee for a company. I guess it was in the late '60s that a number of paper mills were destroyed in a hurricane, and the paper supply of the country shrank, and simultaneously there was an enormous announced rise in second class postal rates for magazines, and I don't know the exact statistics, but I think it was like a 500 percent increase to be phased in.

It was somewhat of a (p. 29) burden for publishers, and so we thought we would all be very clever and try to pass on those increased costs through selling the subscription and adding an amount for postage and handling. Well, the consumers weren't quite as dumb as we all anticipated, and we had our head handed to us, and the whole concept was dropped—not only by us but other people who had tried it.

We've had the case in the State of Maryland where similar circumstances have arisen in sales tax, and we have concluded that the cost of trying to collect the taxes is so enormous that we would rather pay it ourselves and not bother. It will undoubtedly be in litigation, but it just wasn't economically viable for us to try to collect the tax from the subscriber.

Q. Okay. Can you—are you familiar with various tests done by Texas publishers in response to this tax?

A. Yes, I am.

Q. Okay, and can you explain to the Court what the effect of—or how those tests operated, as you understand

them, and the effect (p. 30) they have on the decision to not attempt to directly collect the tax from the consumer who owes the tax?

A. Well, it—it's a—it's a pretty common phenomena that the higher the price the less people are going to order something. In the direct mail business that's particularly true. It's a very price sensitive business. I believe that tests for *Texas Monthly* specifically show a 17.3 drop-off in the number of people who respond when you put sales tax on versus not having the sales tax. I believe *D Magazine* had a test that looked like 18 percent, if I'm not mistaken, and I can't recall the number right now on the other magazine. It seems to me it was in the 20 percent range. I think three tests together all done on a scientific basis gives you adequate knowledge that you're going to experience a drop-off in results. The economic cost of that drop-off doesn't make trying to collect the tax or even to put it on there terribly worthwhile or economically viable for the publisher.

Q. Okay. Now, let's stop here and ask you assuming we've run a test and decided that (p. 31) it depresses their ability to get subscribers so much we're not going to try to collect the tax directly from the reader, then we're faced with the situation in which we'll—the Texas publisher is required to pay the—some amount of money to the State for this tax and chooses to pay in the 6.125 or the applicable percentage rate to the State, but it's faced with a world in which magazines mailed into the state are not paying the tax, okay? Let's make that assumption. Now, first of all, let's test that assumption. Are you familiar

with the practices of collecting taxes for your clients—the ones that—magazines you're working with?

A. I am indeed.

Q. Okay. Do they collect or pay taxes on Texas subscriptions?

A. No, they do not.

Q. And do they make an effort to try to get taxes or pay some sort of tax to the Texas Comptroller on Texas subscribers?

A. No, they do not.

Q. Now, in connection with the effort to determine—is it possible—let me ask you this way: Is it possible to determine what the (p. 32) Texas subscriptions are for national magazines—come up with a reliable estimate of how much money that's out there that could be taxed?

A. Yes, it is. The Audit Bureau of Circulation statements, which is an organization that audits magazine circulation, lists a—what is called a state count and breaks out the subscriber copies by state and U.S. possession of, I think, APO and FPO.

Q. Okay. Now, we've had some estimates in this case of how much tax Texas is collecting from Texas publishers and out of state publishers, and we've had two numbers, one—yesterday we had a revised number of about two and a half million dollars. Before that we had a number of one and a fourth million dollars, as I recall the testimony, and have you done some just kind of basic analysis of what four—just four companies that circulate in Texas—the revenue would be, if it was just those four companies?

A. This evolved out of—

MR. MENDEZ: Before he answers that, Your Honor, we may be getting into—and I'm not sure if Mr. George—if this may be (p. 33) one of the tax payers that is under the protective order, but if we might admonish him not to talk about—

THE COURT: All right. It will be Company A.

MR. GEORGE: He doesn't know that and—

THE COURT: All right. Why don't you explain it to him.

(At this time there was a brief discussion off the record.)

THE WITNESS: This whole discussion evolved out of some prior depositions where I had seen the figure of 1.4 million dollars in collected sales tax. I think at the time of the deposition I did a little quick mental arithmetic and concluded that it wasn't possible for the State of Texas to have collected the tax, because if you took any number of companies on their list, combined they would have paid some enormous amount of sales tax—not 1.4 million dollars. So I took—in that discussion that ensued with Mr. Mendez, I took four companies and did some quick arithmetic there, and then I went home and sort (p. 34) of organized it later, and the four companies, one being Company X, which is a big one, the Meredith Corporation, which is on, I believe, Mr. Mendez' list, the Hearst Corporation, which is on Mr. Mendez' list, and CBS—I looked at their total circulation that they have—their circulation in Texas. I looked at their subscriber circulation in Texas, and then you divide up the world in the two groups. You

divide up the world into—and this is from their Audit Bureau of Circulation statements—the number of copies that paid full price or basic price, as it's called, and the number of copies that were sold at less than basic price.

QUESTIONS BY MR. GEORGE:

Q. Now, what's—you're going to have to explain to the Court and to me the difference between basic price and full price.

A. Basic price is the normal rate they publish as the price of the magazine. For instance, if I use *Colonial Homes* as an example, their basic price is 24.97 a year for 12 issues. Their lower than basic price can be anywhere from 24.96 to 50 percent of that—I guess around $12.50. So we took the copies that were (p. 35) at the basic price, and in order to not get into an area of speculation, we took the lowest less than basic price they sold at. Understand that when they say less than basic price there's a number of prices they sell at that range up and down. We took the absolute lowest and applied that number to all of the other subscriptions, and we concluded using a—well, we concluded that there was some 54 million dollars worth of subscription revenues coming into the State of Texas based on these—

Q. Four companies?

A. —these four companies alone, and those four companies in themselves would have a tax bill of roughly $3,356,000.

Q. Okay, and based upon those calculations, as well as your own personal knowledge, you are confident that

tax isn't being paid by those companies—again the State's estimate of what they're collecting?

A. No, I will say that only one of these four are my clients. There are other clients on Mr. Mendez' list who —and other clients I know specifically who do not pay sales tax in the State of Texas or any other state.

(p. 36) Q. Okay. Do you have that calculation written up?

A. Yes, I do.

(At this time the instrument referred to was marked as Plaintiff's Exhibit No. 51 for identification.)

MR. MENDEZ: I'm going to object to the document on the basis that it was not made available to the defendants prior to the time of this trial and prior to the time the discovery ended. We have an interrogatory and request for identification of documents on file in this case that asks under the Rules of Civil Procedure that all documents that are going to be used in this trial be identified and made available to us prior to the trial, and on the basis of that discovery document and under the cases that apply to it, we don't think that this is an admissible document in this case.

MR. GEORGE: In response to that, the request for the production of the document or the calculations came from Mr. Mendez' examination of the witness on the 24th day of January, which I haven't looked that up, but Mr. Lepere came up with virtually the same (p. 37) conclusions in his head of the calculations at the time, which I'll have to look up the places. I don't think Mr. Mendez will dispute this.

MR. MENDEZ: Your Honor, I don't have an objection to what his testimony is. If he wants to talk about what he did off the top of his head, I'll ask him about that on cross. I'm just saying this exhibit is not admissible.

MR. GEORGE: And the document represents merely a summary of his testimony at this point in time, and the summary of testimony can come in, which he's already testified to.

THE COURT: The rule provides for summary. It's not a document study. It's a summary of testimony.

MR. MENDEZ: Well, Your Honor, I don't know what it is. I've never seen it before.

THE COURT: Well—

MR. GEORGE: He's testified to the facts on the document, and it comes in under the summary rule at this point because he's gone through the document itself (p. 38) and testified to the numbers.

THE COURT: Well, I won't consider the document as something independent, other than from his testimony if he wants to testify to—

MR. MENDEZ: Is it overruled then?

THE COURT: I don't want to—I don't want the ruling to be that the Court is not enforcing the rules with reference to discovery and requirements for submission of documents. If that is the case, then I will not consider it, but otherwise I'll tentatively let it in on the basis that it's on his summary of what his testimony will be here today.

MR. GEORGE: I have—rather than going over the actual numbers that he has done in—he has testified to the

bottom number on the pieces of paper already, and because of our protective order, it makes it somewhat awkward to go into the naming of the magazines and their circulation and the numbers that flow from it. If you'll note at the bottom of the page Company A, and this was a telescoping device. The point of the testimony (p. 39) obviously was they can't be collecting the tax, and he's already testified to that. I think Mr. Mendez certainly can't legitimately—can't claim surprise since the man did the calculations at his request.

MR. MENDEZ: Well, if I may, when was this document prepared, sir?

THE WITNESS: I'd have to look at my calendar and figure out where I was. I was down here for depositions on the 28th? 29?

MR. GEORGE: 25th, I think.

MR. MENDEZ: You were here last week, were you not, sir?

THE WITNESS: And I don't remember the exact dates right now, but I went back to Washington. I was in New York a couple of days. So it was mostly prepared last Thursday and Friday.

MR. MENDEZ: When did you come back to Austin?

THE WITNESS: Saturday evening.

MR. MENDEZ: Did you bring (p. 40) that with you?

THE WITNESS: Yes.

MR. MENDEZ: I still maintain my objection, Your Honor.

THE COURT: All right. I'll sustain the objection insofar as—on the document, but I still want to see it.

QUESTIONS BY MR. GEORGE:

Q. Okay. Now, Mr. Lepere, we've gotten—we're at a situation where we've got this proposition under analysis, whereby we have a company like *Texas Monthly*—*Texas Monthly* in particular, in which it has, because of its test results, decided it cannot collect the tax from its readers and must pay the tax out of its receipts, and it's faced in the world with many magazines in which it deals—competes with not collecting the tax. Can you determine as a result of your experience in making financial analyses of companies that have—and published magazines and appraising them and that sort of thing, determine what the amount of damage the company would suffer under those circumstances?

MR. MENDEZ: I'll object to that question because I don't think he has (p. 41) the basis to make the decision. He doesn't have the educational background, at least from the deposition that I did, to explain to us exactly what calculations he used. All we've heard is that he's been involved in some mergers or some evaluations, but I don't know what extent he's been involved in them, and I know from my deposition that he doesn't have an educational background that goes toward this financial analysis, and I'll object to his making any statement about their economic condition until I—you know, on that basis.

THE COURT: Overrule the objection.

MR. GEORGE: You can answer the question.

THE WITNESS: You'll have to go back and tell me what the question was. I'm sorry.

QUESTIONS BY MR. GEORGE:

Q. Okay. What I'm asking you to do—and we may be able to go through it, and you may be able to do it on the board or at your chair, but the analysis is assuming *Texas Monthly* is remitting the sales tax as out of its gross (p. 42) receipts and nobody else it competes with, from out of state at least, is doing so. It's taking money out of its income stream and remitting to the State and all of these other companies aren't.

MR. MENDEZ: I'll object to his question until he defines which out of state companies he's talking about with nexus or without nexus.

QUESTIONS BY MR. GEORGE:

Q. Well, let's limit it to the companies, for the purpose of this, that solicit—have people in Texas soliciting orders for their companies. That's—we'll limit those, and don't consider *The National Law Journal,* if they don't use Quality School Plans, but you can consider *Reader's Digest* and *Time* and *Newsweek* and *Cosmopolitan* and *Farm & Ranch Living* and all of these others, okay, and making those assumptions, just kind of walk the Court through how you would analyze the loss.

A. Well, Mr. George, there's a number of ways to view the question. Of course, if—if you take the position to just pay the tax—the gross receipts tax, you would look at the (p. 43) erosion of earnings, and that would be some amount—the tax—

Q. Assuming that the tax is—and we'll—we have an annual that we don't have a year's worth precisely of payments, but we're talking about roughly a hundred and

seventy-five thousand dollars a year paid to the State of Texas out of the earnings of this company. You've gone over the financial statements—

A. Yes.

Q. —of the company?

A. You then look at the way magazines are evaluated in this country, or any company, for that matter, has a value put on it. I tend to like to use the New York Stock Exchange listing as a fair and reasonable value.

Q. For magazine companies?

A. For magazine companies in particular, and you look at what those companies trade for in terms of their earnings. It's called a price earnings ratio. It is the amount of money that an investor is willing to pay for a share of that stock. As of January 7th, 1986 the PE value of—I picked five companies—selected companies, some of which are on Mr. Mendez' list (p. 44) and some which are not—

Q. What are the companies, by the way?

A. Dow Jones & Company, publishers for *The Wall Street Journal* and *Barons,* two heavily subscription oriented businesses, McGraw-Hill, publishers of *Business Week,* the Meredith Corporation.

Q. What do they publish?

A. They publish—

Q. Some of them are on your list, I think.

A. It's either—it's *Better Homes & Gardens,* I think. Yeah, *Better Homes & Gardens, Metropolitan Home* and

Successful Farming. They just acquired another magazine called *Ladies' Home Journal,* which is five million in circulation, which will be added to their list. I then took the New York Times Company, which has a large magazine division.

Q. What do they publish, by the way—publicize?

A. They publish *Cruising World*. They publish the alternative to *Woman's Day,* and I can't remember the name of it right off the top of my head. They publish *Golf*. They publish (p. 45) *Skiing* and a number of others.

Q. Okay. Any other companies on your list?

A. And Company X.

Q. Company X.

A. I'm sure I'm not allowed to name Company X.

Q. Okay.

A. The average PE ratio or the price earnings ratio, the price at which an investor is going to pay for a share of stock, was 17.8 times—

Q. Earnings?

A. —earnings, and if you calculate for *Texas Monthly,* you will have an erosion of earnings of approximately a hundred and seventy-five thousand dollars, which is the amount of proportionate tax. You place an economic loss of that of 3.1 million dollars. That is the value, as far as the New York Stock Exchange is concerned—the value of those earnings.

Q. Okay, and now, let me—in terms of a company such as *Texas Monthly* and the magazine business gen-

erally, what is the ratio of (p. 46) earnings ratio—the profit ratio in these companies? Do they make—are they talking about a ten percent return or five percent?

A. I think the average for 1984, which I believe is the last year statistics are available that are published by the Magazine Publisher's Association, was arou..l 11 percent in operating earnings.

Q. Okay. 11 percent return—

A. On sales.

Q. —on sales, and for—now, are you generally familiar with *Texas Monthly's* numbers? Would this be a significant decrease in its operating return?

A. It would be approximately ten percent.

Q. Ten percent reduction in its return? Now, in terms of long-term effect on a magazine in a competitive environment, can you tell the Court some of the impact such results would have, in terms of its competing with *Architect's Digest* for the reading time of people who want to read about the homes?

MR. MENDEZ: I will—is that question directed to one of those magazines— (p. 47) are we still working under the hypothetical that they're under that—in that catalog or something?

QUESTIONS BY MR. GEORGE:

Q. Let me pick one in the catalog. Let's pick something that is—*Harper's Bazaar* or *Gourmet* or *House Beautiful* or *Ladies' Home Journal* or *Money* magazine or *McCall's* or—those are—the New Yorker [sic]—some of the magazines. Assuming that those people are—have so-

liciting agents in Texas soliciting orders and they are competing for the time of the reader with *Texas Monthly* and they don't have this erosion to their earnings and they don't have this effect, what does that do to *Texas Monthly's* relative competitive position?

A. Well, in this case it's pretty straightforward. *Texas Monthly* has a hundred and seventy-five thousand dollars less a year to defend its market, and the converse of that is those folks have a hundred and seventy-five thousand dollar advantage in the State of Texas, if you isolated it to that geographic location.

Q. If you take this and expand the relative numbers so that we're looking at a (p. 48) magazine—for example, let's pick one that is not a Company X magazine but has a large circulation in Texas—*Newsweek*. About how many—do they have more circulation in Texas than *Texas Monthly* has?

A. This will be an estimate is all it will be. They have about 200,000 circulation, I would guess, in the State of Texas.

Q. They have about the same. Let's take Company Xs' largest magazine, all right, sir, and we have some numbers for it.

A. Okay. They would be about equal with *Texas Monthly*.

Q. Company X's would have—

A. Yes.

MR. MENDEZ: Could I see which one you're putting the—where is it? That one?

MR. GEORGE: Company X's largest magazine is number seven on the list of Company X's magazines, I think.

MR. MENDEZ: Okay.

QUESTIONS BY MR. GEORGE:

Q. They all are about the same number of circulation in Texas as *Texas Monthly*?

(p. 49) A. That's correct.

Q. And they are essentially sending the same number of copies to Texans as this company is and not paying a tax; is that—

A. That's correct.

Q. And so the damage to this company, as you calculate it, from doing what they are actually doing, which is paying it as a gross receipts, if valued today and they had to compensate themselves for it based upon these companies publicly traded is 3.1 million dollars; is that correct?

A. That's correct.

Q. Now, let's take it a step further. What is the value of price earnings ratios for privately traded companies you're familiar with? Now, let's—the ones that you've been involved in trades or know from your knowledge as a consultant in this industry—what have they been averaging? Give me some examples, if you would.

A. Mr. — if I could ask you a—I'm not clear on the question.

Q. Well, let's—these are all companies that are listed on the National Stock (p. 50) Exchange. I assume that—and some companies are purchased which are not—by non-public companies that are not public and are purchased for public companies, and you have a purchase price to deal with and you know the earnings of, and you believe *U.S. News & World Report* sold, that *The New Yorker* has sold in the last year, and you're familiar with those transactions, and you know what the price of the magazine in excess times—how much greater it was than the earnings they made?

A. I think you're referring to the premium paid for majority ownership.

Q. Yes.

A. When you buy a share of stock on the stock exchange, you're obviously buying minority ownership. There is a premium to be paid, ergo, all of the leverage buy-outs or takeovers. There's a premium paid for majority ownerships. In the publishing field in the past five years it has—it has—it has become a very dear commodity, I suppose is the best way to say it, and it's not only related to privately held companies. *U.S. News* was privately held, but there was a lot of public information on it. (p. 51) *The New Yorker,* for instance, was a publicly traded stock. I've done a little research into it, and I basically list this as premiums paid for mergers and acquisitions for publishing companies that have been taken over, and the companies are the Chilton Company, which was a major—

Q. How do you spell that?

A. C-h-i-l-t-o-n.

Q. And what do they publish?

A. They publish a bunch of trade magazines primarily.

Q. Okay.

A. But again it was one that was listed on the stock exchange, and you know, it's something we can all point to.

Q. And this is a premium for owning the whole company?

A. True. The price per share prior to the announcement was $26. The price per share paid for the company —a hundred percent ownership—was $86. It was an increase of 231 percent.

Q. Okay.

A. The—I'm not sure I can list this (p. 52) next one because it's part of Company X. It's a division of Company X.

Q. Division of—we'll call it division of Company X.

A. It was acquired by Company X in July of 1977. Its price per share prior to the announcement was $24. Its acquisition price was $30.

Q. And what was that?

A. It's an increase of 25 percent.

Q. 25 percent. Okay. Company X made a pretty good deal compared to Chilton?

A. Indeed. Wadsworth Publishing Company—

Q. What is Wadsworth?

A. Wadsworth is a—

Q. That's W-a—

A. —d-s-w-o-r-t-h. It was given a trade magazine publisher. Its price per share prior to the announcement was nine. It was acquired at a price of $31.50 or 250 percent premium.

Q. Okay.

A. Technical Publishing was acquired by Dunn & Bradstreet in August of 1977. The price (p. 53) per share prior to the announcement was $22.50. The price paid for the acquisition was $29.75 or a 32 percent increase in price.

Q. *U.S. News & World Report* was acquired in 1984. Its appraised price per share, which was public knowledge, was $625, and the purchaser paid $2900 a share for an increase of 364 percent, and the last one was a publicly figured firm, the New Yorker Company, Incorporated, publishers of *The New Yorker*. Its price per share prior to the announcement was a hundred and thirty dollars. Its acquistion price was $200 for an increase of 54 percent, and the average increase—the average premium paid for majority ownership was a hundred and ninety-one point two percent.

Q. So if you applied any of these numbers to this kind of earnings decrease, you would get a much larger number than 3.1 million dollars?

A. Yes, you would. You would come out closer to nine million dollars.

THE COURT: I assume we're not trying to collect this money from the State?

MR. GEORGE: No, we just (p. 54) want to be put back to even. Either they go collect it from all of these people, or they don't collect it from us, one or the other.

I would like to mark this as Plaintiff's Exhibit 52 and offer it into evidence.

(At this time the instrument referred to was marked as Plaintiff's Exhibit No. 52 for identification.)

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Now, Mr. Lepere, let's change the assumption. Let's change the assumption and assume that this company does not make the decision to pay it—the tax for its readers. Let's make the assumption that the company decides that the consumer owes the tax and we're going to collect it from that consumer and we're going to go out and do what's necessary to collect it. Despite the decrease in response to our direct mail packages, we're going to do a—an effort to collect the tax, as the tax statute is apparently written. Making that assumption, have you made any analysis of what the effect (p. 55) that court of action by the company would be on its value?

A. It would be—

MR. MENDEZ: I'll object to the question.

THE COURT: What is it, Counsel?

MR. MENDEZ: He hasn't been shown to have any experience about how to collect taxes, how corporations account for their taxes or how they attempt to get them from the individual subscribers, and he hasn't been shown to have any knowledge of how Texas applies its sales and use tax.

THE COURT: I'm not sure that's his question but—

MR. MENDEZ: He's being asked to give an estimate of the harm to *Texas Monthly*, if it has to go out and collect the taxes from the Texas users, and he doesn't know how the tax applies, or he hasn't been shown to know how the tax applies on it.

MR. GEORGE: Your Honor, when he has testified they've done these tests, they know the response rate fall off—

(p. 56) THE COURT: I assume we are getting back onto these test things that we had testimony on yesterday—

MR. MENDEZ: Yes, sir, but he—

THE COURT: —without objection. I had—all of this testimony came in yesterday with reference to you have a test mailing, and you have a—

MR. MENDEZ: Yes, sir, and I didn't have any objection to those persons because I think that that's valid to show that there's no harm, but what I'm saying is that this person doesn't know—that he didn't do those tests. We don't know what he knows about them.

THE COURT: All right. A few questions to see if he's familiar with the testing.

QUESTIONS BY MR. GEORGE:

Q. Are you familiar with the tests run by *D Magazine, Houston City* magazine and *Texas Monthly,* in connection with the attempts to collect the tax that you've read in the depositions and seen those?

(p. 57) A. Yes, I have. I am familiar with them.

Q. Now, going back to my question, my question is these—this company, *Texas Monthly,* does not make the decision to pay it itself. The company says, "Okay. I'm going to absorb that decrease in response rates and assuming by doing that I can get all of the taxes in and I'll pay them"—making that assumption, what happens if they absorb that decrease in response rates? Can you tell the Court the effect on the company that would have?

A. You would go through a similar exercise. You would look at a—an erosion of the earnings and you would—and I've attempted to do some calculations on that.

Q. Well, let's just kind of run through it quickly. You would have a decrease in your—assuming that we have—using *Texas Monthly's* response, which is the least adverse of them or the 17.2 percent decrease in response—we'll use that number. Okay. Now, what does that do to the company, and kind of run through the analysis for the Court?

A. Do we want to use the actual 1985 (p. 58) figures, or do you want to use the forecast in '86 figures?

Q. Well, why don't we use—why don't we use the actual—assuming '85 is repeated because we have actual numbers to work off of.

A. *Texas Monthly's* average subscription list in 1985 was 241,000 and change, and a loss of 17.3 percent would be a reduction of 41,700. No, any—

Q. Okay.

A. Pardon?

Q. Okay.

A. In here you have a number of areas to look at. Rather than pick on the ones that are subject to speculation and really would require a lot of detail, I stuck to just major ones. You would have a loss in subscription revenue of roughly $576,000.

Q. Now, that's a sub 566,000—

A. $576,000 in lost subscription revenue.

Q. All right.

A. Since advertising is sold on a basis of what's called cost per thousand readers—

Q. This is, a company with 200,000 (p. 59) readers charges less than a company for each page of advertising than the company with 240,000?

A. That's correct, but based on a cost per thousand basis, the lost advertising revenue would be approximately $2,072,000.

Q. All right.

A. There's a loss in what is referred to as ancillary revenue, which is the revenues of magazines derived from renting their lists from selling products to their subscribers, and on an average basis, that looks like $37,000.

We saw a little less than $1 in products to each subscriber to the *Texas Monthly* file.

Q. Now, this is—*Texas Monthly* would rent its list to *Newsweek* to solicit ads?

A. Yes.

Q. Solicit subscriptions?

A. Solicit subscriptions. They rent it to Book of the Month Club or rent it to Bloomingdales to sell whatever Bloomingdales wants to sell. Another area that's major is the lost revenue from insert cards out of the magazine—the little cards that tend to fall out and annoy most readers. Because your (p. 60) subscription lists will be down 41,000 copies, you'll have less of those cards. We calculate that to be about $43,000.

Q. All right.

A. Sum total of the lost revenue is about $2,727,000?

A. Two million seven hundred—

A. Twenty-seven.

Q. Okay.

A. And there are some savings that accrue in this to *Texas Monthly* also, which offset part of that. Obviously if they're producing 41,000 less copies, they've got $41,000 less the cost of printing the magazine, and based on their '85 costs, that is roughly $357,000.

Q. All right.

A. They've got a savings in distribution cost or postage costs primarily, because of sending 41,000 fewer magazines a month, of roughly $93,000.

Q. Anything else?

A. They've got a savings in advertising agency commissions, which is the commission—they sell an ad for a thousand dollars. The (p. 61) advertiser pays a thousand dollars to the agency. The agency keeps the commission and remits the rest to the publisher. That commission rate for *Texas Monthly* in 1985 was 14.22 percent. So they would save about $295,000 in advertising agency commissions. The net lost earnings—well, the total savings, Mr. George, would be about $744,000 approximately.

Q. Okay.

A. And the net change in earnings or net erosion of earnings would be approximately $1,984,000.

Q. 1,984,000, okay, and that's earnings decrease?

A. That's an earnings decrease, earnings erosion. I'm afraid neither you—neither you nor Mr. Mendez really—really understand that that is—that is a—that is a straight line, strictly arithmetic problem over there. There's a whole set of other problems that occur when you decrease your rate base. The advertising community is not going to look very fondly on that. Your competitors—*Texas Monthly's* competitors are going to look at a reduction in *Texas Monthly's* circulation as a (p. 62) major sign of weakness, and indeed I would anticipate the erosion in advertising to be far greater and—

Q. When the regional—the guy who's selling ads for *Time*—I'm sorry—for *Newsweek* or some other company in Texas to—RepublicBanks run ads in national magazines, and he comes in and wants to sell ads for that magazine. He would be competing with *Texas Monthly?*

A. Correct.

Q. For selling ads to the same bank chain?

A. That's correct.

Q. And he would be able to go and say, "Mr. Bank Advertising Director, this magazine is losing subscribers, and they must not be doing very good. So don't trade with them, even though their price per page is lower because they're going down, and we're going up"?

A. That's correct.

Q. But you haven't included that because you don't know how to quantify it?

A. It's quantifiable, but I don't believe it will ever happen because I don't (p. 63) think *Texas Monthly* could withstand the onslaught of competition at that point, and they would—they would elect to pay the tax themselves. Doing that would be like rearranging the deck chairs on the Titanic. It would just be impossible.

Q. The company would essentially not be able to continue to be viable?

A. I would dare say *Texas Monthly* would be out of business in two years. I don't think they could survive that kind of reduction.

Q. And if you take that $1,984,000 and apply these capitalization rates that you get, you'd get a loss number of—

A. It becomes an extraordinary number on the asset, and that's really what you're dealing with is a value of that asset. You know magazines—magazines don't have

any hard assets. They don't have any trucks, and they don't have printing plants. They've got a name and a reputation period, and they've got a printed page they put out every month, unlike a newspaper or broadcast organization. That asset can depreciate very quickly and be a memory.

MR. GEORGE: Before I (p. 64) forget I need to mark and offer this as Exhibit 53.

(At this time an instrument was marked as Plaintiff's Exhibit No. 53 for identification.)

THE COURT: Any objection?

MR. MENDEZ: Can we withhold on the admission of this until I've had an opportunity to cross examine him on it?

MR. GEORGE: No, I object to that procedure. Either it's in or out, and he can question it on the weight of it, if he wants to.

THE COURT: What's your objection? Do you have an objection?

MR. MENDEZ: I'm not sure how he arrived at that number up there—17.2, and I'm not sure whether, from what—from the direct examination here, what relevance that has to these calculations as to—

THE COURT: I know but what's your objection? You're stating what you don't understand, but what's your objection?

MR. MENDEZ: I think it's inadmissible hearsay, or it's based on (p. 65) inadmissible hearsay, and I want to

know what he used to arrive at them before I object or don't object to that.

THE COURT: I'll overrule the objection.

MR. GEORGE: Now, with that I will pass the witness.

MR. MENDEZ: May I have about five minutes to organize my cross examination so that we can—

THE COURT: We'll take a 15-minute recess.

MR. MENDEZ: Thank you.

(At this time a brief recess was taken, after which time the proceedings continued as follows:)

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Lepere, we've met before; right?

A. Yes, we have.

Q. Okay. We had a deposition last week on this case; right?

A. Yes, sir, we have.

Q. And we discussed—at that time you (p. 66) didn't have an opinion about the economic effect on this corporation; is that correct?

A. Mr. Mendez, I had obviously a general opinion. I didn't have the details of it, and rather than confuse the issue with a lot of speculation, I thought it would be best to just do the fundamental arithmetic of the problem.

Q. Okay, sir, and but you didn't have a number or a calculation of what number was the effect on *Texas*

Monthly as a result of its having to collect a tax; is that correct?

A. I think like the—

Q. Sir, I'm just asking you if that's a correct statement or not. Is it a yes or no answer?

A. Well, it's not quite a yes or no answer.

Q. Okay. Well, go ahead.

A. Like the problem of what other companies should be paying a sales tax, I tried to do some rough arithmetic for you at the table. As I recall you asked me specifically how I was going to arrive at the number, since I didn't have one, and I outlined the general (p. 67) framework of it.

Q. Okay, sir, and did you give me a methodology of how you would arrive at those numbers?

A. I gave you a rough knee-jerk methodology at the time.

Q. Okay, sir. Well, I want to make sure before you go on that did you change that methodology after you left that deposition and actually did these numbers that you're testifying here today? Did you change the methodology from what you told me you were going to use?

A. Very slightly.

Q. Okay. What did you change?

A. In the—in general what I've done is, rather than getting into issues of losses and earnings and additional costs that were detailed and subject to speculation, I eliminated that. I just threw them out—the same thing in what

magazines should be paying in sales tax. Instead of trying to calculate all of the subscription prices paid, I used the absolute lowest number. In the case of these actual costs, I think one of the items I had (p. 68) outlined in the methodology was the cost of administering the tax. There is a cost associated with it. There's additional fulfillment charges. There's additional cost of materials. There's trying to get a fulfillment house, which is the places that process orders in open mail to change their programs to carry these records. At this point in time the one I spoke to said they could not do it.

Q. Okay, sir.

A. And I threw things like that just out. I didn't include them in the calculations.

Q. And you don't think they're valid in your calculation; is that correct?

A. They're valid, but I think we could spend the next two weeks discussing each individual item.

Q. Well, sir, would they make this estimate more accurate?

A. They would make the estimate of economic loss higher.

Q. Would they make it more accurate?

A. No. I mean, it's within five or ten percent right now.

Q. Well, that's what I'm asking you. (p. 69) Would it make it more accurate?

A. Sure. In that sense it would make it more accurate.

Q. And it's your testimony that you did this estimate using the methodology that you did because of the time constraint that you were under; is that correct?

A. No, that is not correct. I did it because I did not want to involve the State or the Court in lengthy discussions of the cost of adding trailer records to fulfillment files at a fulfillment house in Iowa.

Q. Well, sir, if that lent to the accuracy of the number that we're trying to figure out and if that's the issue before this Court as to what that number is and to the best, most calculable stage that it can get at, then why don't you think that it's relevant for this Court to hear it or to have it as part of this estimate that you've prepared?

A. Mr. Mendez, it's the difference between getting a cost of building a house based on lumber, nails, blueprints, kitchen equipment and doing an estimate on a house based on the number of man hours it takes to cut two by fours (p. 70) up. It's just—it's just incredible detail.

Q. Okay, sir, but it is your testimony that that would make this number correct or more accurate; is that correct?

A. It would make it more accurate. It would inflate the number, and I didn't feel that it was that necessary.

Q. Okay, sir. Now, I want to go back—before we go into this case, I want to go back. What is your educational background? Could you explain that to the Court, please?

A. I graduated from high school. I have about 60 credit hours college from the University of Virginia from the Northern Virginia campus.

Q. Do you have any other educational experiences?

A. Attending trade seminars and whatnot but not on a formal basis.

Q. While you were at that university, did you study economics?

A. Yes.

Q. What courses in economics did you have?

A. Economics 101, 102 and 103.

(p. 71) Q. And did you study anything about finance?

A. Yes, I did.

Q. What courses in finance do you have?

A. Accounting, purchasing materials and management, math, and then there were some other courses but I can't—

Q. You have 60 hours; is that correct?

A. Roughly 60 hours.

Q. That's approximately two years' worth of college?

A. Yes.

Q. Okay, sir, and you're involved here—it says on your resume, which is an exhibit in this case, that you're involved in consulting with a list of clients that you've written here and that you're involved in making decisions as to their management, their marketing, their circulation programs, their finance, their investment analysis, their

acquisitions and divestitures, their appraisals. Are those things that you do for them?

A. Yes, they are.

Q. Okay, and what other educational background do you have, with respect to (p. 72) economics or finance or accounting that go to this—and what I'm asking is I'm asking about formal training that go to these types of consultations?

A. Mr. Mendez, there are no formal classes—there are now, but when I was getting out of high school and coming into the work force there were no formal classes in, quote, magazine management. There are very few today. Most journalism schools taught journalism, writing. I went to school at night carrying about nine credit hours a semester. By the time I completed whatever I was completing, I was already in the work force for—

Q. Okay, sir.

A. —four or five years and picked up much of my experience in just on-the-job training.

Q. Okay, sir. Could you explain for the Court what experience you have with respect to acquisitions and divestitures, and in particular, could you explain for the Court what you did with respect to the merger of or acquisition of Morgan Stanley Corporation?

A. I only wish I could acquire Morgan (p. 73) Stanley. Morgan Stanley is a major—it's a premier investment banking house started by J. P. Morgan. Morgan Stanley requested my assistance on behalf of one of their clients, Price Communications, in the acquisition of a company

called Law Journal Publishing Company, which are the publishers of *The New York Law Journal,* a daily newspaper for the courts and lawyers, and *The National Law Journal,* a weekly newspaper for the legal community, but it was not the acquisition of Morgan Stanley.

Q. Okay, sir. Well, you say that you were involved in the acquisition for *U.S. News & World Report.* What did you do for them?

A. I'm not sure which question you want me to answer. Do you want me to answer the first one or the second one?

Q. Well, was there an acquisition that you were involved in that involved the company, *U.S. News & World Report?*

A. Yes, there was.

Q. And what did you do for them?

A. I led a group that sought to acquire the company, and I was an equity participant in that.

(p. 74) Q. What's an equity participant?

A. I would be an owner of the business.

Q. What did you do to decide or not to buy this company or to become—to become an owner of this company?

A. Well, we—when the documents were made available—their historical records—we analyzed the business. We analyzed how we would improve the business. We analyzed where we thought the market was going for the magazine and what its opportunities were in the future, and we made a conclusion on what we felt we could pay for the business.

Q. Who was involved in this team of persons that you worked with?

A. Myself, the communications lending group, Bank of Montreal, Citicorp Capital Investors, which is Citicorp's venture capital arm, if you will. They're in business to fund—fund entrepreneurs basically and a host of lawyers, accountants, whatnot.

Q. Okay, sir, and what kinds of documents did they give you?

A. What kind of documents did who give me?

(p. 75) Q. Well, the company that you were looking to acquire. What kind of records or historical documents did you get from them?

A. Jesus, just about anything you asked for—obviously all of their financial data—historical financial data.

Q. Well, what was your role—your specific role in analyzing those records?

A. My role was to evaluate that information, to make an assessment of how the business could be improved, if it could be improved, if it had a future that would justify a given acquisition price.

Q. And how did you analyze the specific price for that company?

A. I—we analyzed what we felt the company could produce in earnings in the future. We looked at what we thought we could pay for it as a maximum, and did it provide a decent rate of return for the investors.

Q. Well, you keep saying we, and I keep saying, well, what you did. What I'm trying to get at is what function—what job title or what thing did you do with respect to that analysis? If you had accountants that actually (p. 76) looked at the financial records or if you had lawyers that looked at the underlying transaction or the contract, well, say that, but what I'm asking is what was your role?

A. Mr. Mendez, I am not a lawyer. So I am not equipped to read a long contract with a printer and really discover the ins and outs of that contract. I can look at the printing contract and make a judgment whether it's a good contract, whether you can get a better price elsewhere. I can ask a lawyer to say—to tell me, upon reviewing it, "Gee, if I can get a better contract elsewhere and improve the business, what is my obligation to this printer?" He has got to tell me that. I'm obviously not equipped to do it. My role was to analyze those numbers as best I could and to make an assessment of what the business—how the business would perform in the future given certain circumstances and what a reasonable price was we could pay for it—that obviously and the subject of the review of the lending institutions, which they looked at very hard.

Q. Okay, sir, and what kind of tools do you use to make this analysis of what they're (p. 77) going to do in the future?

A. They are judgments based on my experience in where the market is going. I can't predict for you that the economy is going to be up 20 percent next year. I can make a guess at what its going to be, but no one knows.

Q. Well, is this a guess based on just, you know, plucking a number out of the air or do you—

A. Not at all.

Q. Well, where do you get it?

A. You get it from fundamental experience and the—in the specific case of magazines, for instance, we felt that personal financial advertising would be on the rise in the next two to three years, and we had determined that a minor shift in editorial focus would allow us to attract that advertising more so than they had to date. That's the type of assessment one has to make, and it's a judgment call.

Q. So you—your testimony is that at least with regard to mergers and acquisitions and at least with regard to this *U.S. World & News Report* merger—

(p. 78) A. It's *U.S. News & World Report*.

Q. —your job was to give a judgment call, as to what you thought that business was going to be worth?

A. It was my place to determine how the business would perform and what we could reasonably pay for it, given the rates of returns that were expected from the investors.

Q. Okay, sir. You mentioned that you've done tax analysis or evaluations for tax purposes before. Could you give us an example of a company that you've done a tax analysis for?

A. I have to ask a different question, if I may?

Q. Sure.

A. Your Honor, some of this is very privileged and private information. They're privately held companies and it's not—

THE COURT: We can give some designations. I don't—it doesn't make any—

QUESTIONS BY MR. MENDEZ:

Q. Sir, you don't have to tell me what the name of the company was. If you'll tell me what state it was in and what the circumstances (p. 79) were so that I could get an idea of what you're talking about, that's fine with me. What I'm trying to get an idea of is what type of transaction were you looking at, and what did you do with it?

A. A case in California, a privately-held company publishes four consumer magazines. The owner is roughly 50. Question of how you disperse stock to the children, and I'm not a tax lawyer, but the question of valuations arise in order to distribute that stock, and my job was to place a valuation on the company at the date that some stock was given to the children.

Q. Okay, sir, and did you do this on your own or with a team?

A. On my own.

Q. Okay, and what records did you require from the corporation to do that?

A. Their financial records and their historical operating statistics.

Q. Okay, sir, and what tools did you use to analyze those records to arrive at a value?

A. Literal tools?

(p. 80) Q. Well, sir, what I'm asking is what concepts—what economic or financial or accounting concepts

did you use to arrive at a number which you used for tax analysis purposes?

A. I don't have to deal with accounting concepts because they prepare their records in what is referred to as GAAP, Generally Accepted Accounting Principles, and it's audited by the big eight accounting firms. So I don't have to deal with it. I have to deal with the underlying assets of the business and the value of the magazines.

Q. Okay, sir.

A. And it's earning—obviously it's earning power. If you take the strict Internal Revenue Service definition of that, I think they look at the earning capacity of the business, the dividend capacity of the business, and there's six or seven points that are looked at, but I just can't rattle them off.

Q. I guess what I'm trying to get—of course, I'm not trying to harass you. All I'm trying to find out is how you go about doing your job. Did you give them a number that said, "Yes, at the date of transfer this is how much (p. 81) these number of shares were worth"?

A. I gave them an analysis that said, "At the date of transfer this is what the fair market value of a share of stock in this company is."

Q. And that was your opinion?

A. Yes.

Q. And how did you get from the data they gave you to there?

A. Not too dissimilar from what we've done here. People have a way of valuing things that I sort of describe

as bordering on voodoo. Obviously the value of something is the price at which something will trade hands between a willing buyer and a willing seller. I think the phrase is neither under compulsion to buy or sell and both having reasonable knowledge of all of the facts. That's all I'm attempting to get at in this case is what is a fair market value. Today if you sold a minority interest in the company, what would it trade at? So I tend to look—instead of dreaming up things, which is easy to do to prove a point, I tend to look at public records where you can point to something and say, "Here is a similar company that's in a (p. 82) similar business, and here's what it sells for."

Q. Okay, sir. Do you look at their GAAP financial statements? Do you look at their Generally Accepted Accounting Principles financial statements?

A. Yes.

Q. Did that company have some?

A. Yes.

Q. Okay. When you're going—do you look at their balance sheet?

A. Yes.

Q. Okay. When you're looking through the balance sheet, do you take out the deferred credits that are listed on there and not classify them as assets?

A. There are a number of ratios you look at. You look at the current ratios. You look at debt to equity ratios.

Q. Well, how did you calculate the debt to equity ratio in a corporation?

A. You know, the current debt to equity ratio? Long-term debt to equity ratio?

Q. The current.

A. The current is very simple. You look at their short-term debt. It's called a (p. 83) quick ratio—their short-term debt and liabilities compared to their cash, accounts receivable, liquid assets, if you will, and that's your current ratio.

Q. Okay, sir, and how would you do it on a long-term basis?

A. It's essentially the same number. It is a—but just taking the long-term portion of that including plant, equipment, long-term assets on the balance sheet credit side.

Q. Okay, sir. Do you have any experience with regard to the—with any sales tax of any state other than the State of Maryland?

A. District of Columbia where I live. I pay sales tax there.

Q. Have you done any consultation work for any one of these many clients that you've listed in your resume regarding their sales or use tax?

A. Only *Baltimore Magazine*.

Q. And isn't it true that in the *Baltimore Magazine* situation they did an analysis of whether or not to solicit the sales or use tax from their customers and then (p. 84) eventually decided not to do that?

A. That's correct. We—I'm an advisor to them, and we made the judgment to go ahead and pay the tax and

argue about it later, rather than taking the decrease in response from our subscribers.

Q. Sure. Now, sir, do you know if—when did you do that analysis?

A. I think we added the tax about a year ago. So the analysis was done subsequent to that or prior to that point.

Q. Okay, sir, and do you know if there is still a tax applicable to the *Baltimore Magazine* in Maryland?

A. Well, we are paying a sales tax, if that's what you mean. We just included it in the price. We would sell a subscription for $7.95 instead of adding—and I think the tax ratio is five or six percent. I'm not positive. Instead of adding five or six percent to it, we just included it as part of the 7.95 pricing. We pay it ourselves as gross receipts tax basically.

Q. Is the company still operating?

A. Yes, it is.

(p. 85) Q. Okay. How long has that company been in operation?

A. It's been in operation for at least 70 years. It was purchased by its most recent owners—it was a magazine published by the Chamber of Commerce up until either 1976 or 1977 when my clients subsequently bought it.

Q. Was that a situation where they became subject to use tax or sales tax, or was there a raise—an increase in taxes all of a sudden?

A. It was a case where the State of Maryland decided that they should be included in sales tax, and I guess

it was an expanding of the definition of what—what is under sales tax.

Q. Okay, sir. Now, I want to get into some testimony that you gave about *Architectural Digest*, a publication that you say you're familiar with; is that correct?

A. Correct.

Q. Okay, and they're a client of yours, aren't they?

A. Yes, it's published by Knapp Communications Corporation.

(p. 86) Q. Do you know if it pays the Texas sales and use tax?

A. I don't believe they do.

Q. Okay, and when was the last time you talked to them?

A. Two weeks ago.

Q. Okay, sir, and they didn't mention anything about Texas sales or use tax?

A. No, there would be no reason for us to talk about it.

Q. Do you know if they have an office in Texas of any sort?

A. They don't have an office in Texas.

Q. Do you know if they have a warehouse in Texas?

A. I don't believe so.

Q. Okay. Are they listed in any one of those *TV Guide* or Quality School Plan exhibits?

A. I'm sure at least one, if not all three or four of the magazines are. If you would like me to check, I will.

Q. No, that's fine, but to the best of your understanding, they're listed in that?

A. Yes.

Q. And they're not remitting sales or (p. 87) use tax to the best of your knowledge?

A. That's correct.

Q. Do you know if X Company has any offices in the State of Texas?

A. I'm almost positive they have an advertising sales office in Texas.

Q. What city is it in?

A. I believe it's in Dallas.

Q. Okay, and would you have a document or something that you could look at to find out if they do?

A. I could look at their advertising rate card, or I suspect it's listed in a publication called Standard Rate and Data.

MR. MENDEZ: If I may, Your Honor, may I approach—

QUESTIONS BY MR. MENDEZ:

Q. I'll hand you what has previously been marked as Defendants' Exhibit No. 1. Can you identify that document?

A. It's an Audit Bureau of Circulation Magazine Publisher's Statement. It is an estimate of what their paid

circulation is subject to an audit by the Audit Bureau of Circulation.

(p. 88) Q. And you're familiar with those documents?

A. Yes.

Q. And you use them in your work, don't you?

A. Yes, I do.

Q. Is there any place on there—is there any function of the Audit Bureau of Circulation that requires the listing of any offices or contacts that a company might have in each particular state?

A. No, it does not. It's just their—what they call their home office or publishing office.

Q. Sir, there's a—you mentioned a magazine called—or a company called Meredith?

A. Yes.

Q. I'm not familiar with what publications it puts out. Could you explain to us what they publish?

A. Meredith publishes—well, they just acquired *Ladies' Home Journal* recently, and Your Honor, if I may borrow that list?

MR. GEORGE: Here is a—this one?

(p. 89) THE WITNESS: They publish *Better Homes & Gardens*, a magazine called *Metropolitan Home*, which formerly was called *Apartment Life*, and they publish *Successful Farming*.

QUESTIONS BY MR. MENDEZ:

Q. Okay, sir. Do you know if that corporation maintains an office in the State of Texas?

A. No, I do not.

Q. And how about a warehouse?

A. No, I do not.

Q. For CBS and Hearst, which you also mentioned as having circulation in the State of Texas and compared in certain analysis in your testimony, do you know if those two companies maintain offices in the State of Texas?

A. No, they do not.

Q. Okay, sir.

A. I do know they sell advertising in the State of Texas, and they certainly sell subscriptions.

Q. You mentioned that you'd done a calculation—you were testifying to the Court that you had done a calculation of how much tax (p. 90) X Company should have remitted to the State of Texas. What number did you come up with for a year?

A. 2.065 million dollars.

Q. Okay, sir, and do you know what rate X Company remits—

A. I beg your pardon?

Q. Do you know what rate X Company remits or reports its Texas sales and use tax at?

A. No, I think the discussion we were having at that time was about whether indeed you could have collected taxes from these folks.

Q. Well, what rate did you use to arrive at your—

A. I used 6.12 percent.

Q. Okay, sir, and with respect to X Company, what deductions did you make from their total circulation on their ABC report to arrive at Texas taxable sales.

A. I'm sorry?

Q. What deductions did you make from their gross receipts from Texas business to arrive at their taxable receipts in Texas business?

A. I took what their circulation was (p. 91) and the number of copies they put into the state based on their own statements times their stated prices to provide a value of subscription copies coming into the state based on their data and publicly known data and applied a 6.12 percent tax rate to them.

Q. Do you know if there are any applicable deductions to that?

A. No.

Q. Are you familiar with the Texas Sales and Use Tax Act?

A. No, I'm not.

Q. So you just took a gross number and multiplied it by that tax rate?

A. That's correct.

Q. And if there are deductions at that company—are you privy to X Corporation's—X Inc.'s records?

A. No, I'm not.

Q. Are they one of your clients?

A. No, they're not.

Q. Okay, and would you know if they might have had other—

A. Let me—a division of theirs is one of my clients, but it was not a magazine (p. 92) division. It was a book division.

Q. Okay, and with respect to the magazine publishing divisions, would you know what they might have reported in terms of tax?

A. No, I would not.

Q. Do you know or did you take into consideration the fact that they might have paid tax in another state, and that would have applied as a deduction to the Texas tax?

A. Similarly my answer is no, I did not, but I only know of two states that indeed comport to what you're proposing.

Q. Okay. Which states are that?

A. That's you and the State of Maryland.

Q. Well, are you familiar with the fact that certain states other—I mean, and not just those two but that other states require the shippers of goods to pay the sales tax in their home state, regardless of where the ultimate destination of that product is going?

A. I know of no such thing like that in the magazine business, which is the only real business I can speak to.

Q. But I'm asking about taxes in general and about the administration of State (p. 93) sales and use taxes, and I'm asking you, from your knowledge of those, are you familiar with that concept?

A. No, I'm not—

Q. So if they're—

A. —but I'm not a tax expert either.

Q. Okay, sir, and you mentioned that you'd calculated tax for several other companies or a possible tax. Did you do it in the same way?

A. Yes, I did.

Q. Okay.

THE COURT: Do you need a drink of water?

THE WITNESS: No, no, I'm fine. Thank you.

QUESTIONS BY MR. MENDEZ:

Q. I'd like to turn now, sir, to your estimates over here that you've come up with, Plaintiff's Exhibits 52 and 53. You've picked, it seems like, five companies over there to use, and is it fair to say that you're using those because they have a publication that has similar circulation in Texas to *Texas Monthly?* Is that why you picked those?

(p. 94) A. No, I picked them in part because they're in the magazine subscription business, or in the case of *The Wall Street Journal*, heavily into the magazine subscription business. It's a newspaper obviously. I picked

some of them in part because they were on your list of the State of Texas—whatever that list was you gave me at the deposition, and I picked them partly because they're publicly traded, and we don't have to speculate on what the market value of their stock is or their earnings are—that it's recorded in the paper every day.

Q. And they've got generally accepted accounting—they have GAAP financials?

A. But by being on the stock exchange, they are required to.

Q. Okay. Did you calculate their price earnings ratio?

A. Yes. Well, I didn't—in fact, I just took it out of the paper as is published.

Q. Okay. As of January 7th?

A. As of January 7th.

Q. Do you know what period of time is used in the calculation of that January 7th price earnings ratio?

(p. 95) A. It is the earnings they paid in the preceding year.

Q. What are the accounting years for those corporations?

A. I would have to look them up. I can't tell you specifically.

Q. Would they relate specifically to the accounting period that you used for *Texas Monthly*?

A. Not necessarily, but it's an annualized—it's an annualized number. So I'm not sure it's real—really necessary.

Q. Well, what's a price earnings ratio?

A. Price earnings ratio is the price of the stock that's trading on any given day divided by the earnings of the company in the last—in the preceding year.

Q. So if the price of the stock changes one day, then the price earnings ratio changes?

A. That's correct.

Q. So if the price of one of those stocks had been $2 less the day before January 7th, then its price earnings ratio would have been some other number; is that correct?

A. That's correct.

(p. 96) Q. And did you go back and figure their price earnings ratio, let's say, a year ago?

A. No.

Q. Okay, and did you project a possible price earnings ratio for those companies for future years?

A. No.

Q. Okay. So this is just a static picture of their price earnings ratio at one period of time?

A. Yeah, it's a—you know, again, Mr. Mendez, I don't like to get into the voodoo of what something is worth. I try to look for a record that is clear and understandable and its consistent, and, yes, if the stock market collapses, the PE ratio of Dow Jones is going to plummet, and if the stock market goes up another 400 points, the PE ratio of Dow Jones Company is going to rise.

Q. Well, sir, I'm just—

A. I have a *Wall Street Journal* in my brief case. I'm sure those PE ratios changed from January 7th to today, and I'll be glad to look them up.

Q. I'm not trying to harass you, sir. (p. 97) All I'm trying to—I don't know anything about finance. I'm asking for you to explain to me what the relevance of this 17.8 number is, and what I'm asking—it seems to me that if it changes every day then the fact that it was 17.8 as an average for these companies on that January 7th—it doesn't mean anything because it could have been 5.1 the day before or—

A. No, no, no. Wait. I beg your pardon. It would not be 5.1. There would have to be a crash in the stock market akin to 1929 for that to occur, or they would have to discover that Dow Jones Company had misreported its earnings by some staggering amount for some period of time in the past, and that is just an incredibly unlikely scenario.

Q. Okay, sir. So that's why you're using this 17.8 number; is that correct?

A. I'm using it because I don't want to involve the Court in a lot of speculation. I don't want to waste the Court's time with it, and I'm looking for a number that's fairly consistent over a long period of time that's reported daily in public records that you can point to—that anybody in this courtroom can (p. 98) point to and say, "That's what an investor values a share of stock in Dow Jones at."

Q. Okay, sir. What's the total net worth of Dow Jones?

A. I would have to go get their annual report and tell you, but this isn't valuing their net worth. This is valuing their earnings.

Q. Okay. What are the total earnings for a year for that corporation?

A. They're enormous, but whether it's a dollar of earnings or a hundred million dollars of earnings, it's still being valued.

Q. And on what basis?

A. By what the market believes—and we're all part of the market—the value of that company is.

Q. Okay, sir, and there's a general market, the New York Stock Exchange, that all of these persons trade on; is that correct?

A. Well, one trades on the American Stock Exchange —New York Times.

Q. Publicly held corporations?

A. That's correct.

Q. Shares traded every day?

(p. 99) A. That's correct.

Q. Now, what does that have to do with Texas Monthly, Inc.?

A. It gives you a benchmark to say what the earnings of *Texas Monthly* are worth in the public market.

Q. Well, what are the total earnings of *Texas Monthly*, let's say, for that last year?

A. I'm not sure that's a—Your Honor, I'm sorry. I don't know if that's a piece of privileged information or not.

Q. Well, let me withdraw that question. Can you calculate the price earnings ratio of *Texas Monthly?*

A. Yes, it's 17.8 on January 7th, 19—

Q. No, sir. I'm asking you you've told me how you calculate price earnings ratios. You take their earnings, and you divide it by the price of that stock at any point in time, and I'm asking you how can you calculate for me what the price earnings ratio of *Texas Monthly* is?

A. *Texas Monthly* is not a publicly held company. So obviously it has no stated price earnings ratio. If tomorrow we did a public offering of *Texas Monthly* and we sold a million (p. 100) shares of stock, it would have a stock price of about $35, and that would be—

Q. How did you get that?

A. That would be simply their earnings divided by a million shares of stock outstanding divided by the PE ratio that the market would value the company at.

Q. What are their earnings to arrive at $35?

MR. GEORGE: Your Honor, we have a protective order about certain financial data regarding the underlying value. I'm not sure what—honestly what this all has to do with the valuation he's gone through—a price earnings ratio, which is obviously—

THE COURT: What is your purpose, Counsel? What are you trying to show the Court? I'm interested, of course, in knowing what you're trying to show the Court.

MR. MENDEZ: I may be a little bit too paranoid, but what's going on here is somebody goes to the New York Stock Exchange, and we've got five relatively big companies there. We don't know what their operations are. There's no evidence here about (p. 101) what's going on with regard to those companies and where they're selling things, and we have a ratio there, 17.8, that wasn't even calculated by this person. It was calculated—it was taken directly from the records, I guess, of the *Wall Street Journal* or whatever of January the 7th, and then we're taking that number, and we're saying *Texas Monthly* has a loss of 3.1 million dollars because of that 17.8 number. Those companies have nothing to do—those operations have nothing to do with what *Texas Monthly* does because *Texas Monthly* isn't publicly traded. In fact, you can't even calculate a price earnings ratio for that company. Now, what I'm showing goes to the weight of the evidence. I was trying to figure out how to object to these exhibits, but what it goes to is really the weight. I'm trying to show that you can't use one number to get to the other, and that's the only reason I'm trying to—

THE COURT: All right.

MR. MENDEZ: If I may continue, Your Honor?

THE COURT: I still don't quite understand, but I'll let you continue. (p. 102) I'm not—continue with cross examination.

MR. MENDEZ: Okay. Can I ask him that question as to how he figured out their price earnings ratio and how he knows that it's the same as—

MR. GEORGE: Your Honor, the man has answered the question. There is no established—the problem, of

course, is that *Texas Monthly* is not publicly trade. So we can't look up their price. The element in determining a ratio requires two things—a price and earnings. We do not have a price for *Texas Monthly* because there is nobody buying and selling the stock.

THE COURT: I understand.

MR. GEORGE: Yes, sir, but he—

MR. MENDEZ: But he went one step further—well, go ahead.

MR. GEORGE: He has answered the question in saying that he has taken a ratio that is available for similar companies that do trade and do have prices and do have earnings both, and he comes up with a composite number of 17 percent as the ratio for (p. 103) thos ecompanies and assumed, for the purpose of coming up with his estimate of damages, that *Texas Monthly* would trade, if it was sold, at the same ratio those companies do, and then applied that ratio number to the—

THE COURT: I understand what he's done. I'm just trying to get what—

MR. GEORGE: And I'm not sure—and Mr. Mendez has asked him what's the price for *Texas Monthly* three times, and he says there's no price, and he's asked it again. That was his last question, and that's been asked and answered is the subject of my objection.

THE COURT: All right.

MR. MENDEZ: What's my instruction, Your Honor? I can't ask him—

THE COURT: Well, ask him—what was your last question? I want to know—

MR. MENDEZ: He said on his last response that *Texas Monthly*, if you sold it on the open market tomorrow, was $35 per share.

THE COURT: Okay. You have your answer then.

MR. MENDEZ: I want to (p. 104) know how he figured out he got the $35 because then he's got a price earnings ratio—assuming he wants to get into that. I mean, if he wants—I mean, I guess he can't withdraw his answer. I can go on to another topic. I think I made my point on that.

THE WITNESS: Mr. Mendez, maybe I can be helpful to you.

QUESTIONS BY MR. MENDEZ:

Q. No, let me just ask you some questions in another area, and we'll try to figure this out. There's a little box on plaintiff's Exhibit No. 52. Do you see that boxed off area on the bottom that Mr. George set up there?

A. Yes, I do.

Q. Two things you can arrive at from that set of numbers, right? One is the thing you came up with that—

THE COURT: What box are you talking about, Counsel?

MR. MENDEZ: That square box over here.

THE COURT: Oh, you're talking about where the percentages are? All (p. 105) right.

QUESTIONS BY MR. MENDEZ:

Q. Now, Mr. Lepere, you'll agree with me that there's two things you can come up with from there. You can come up with the conclusion from that that there's an average of a hundred and ninety-one point two percent premium paid when somebody purchases—does a buy-out of companies; is that correct?

A. That's the premium that has been paid over the last few acquisitions for a majority interest in the company.

Q. On those—no, those five companies?

A. On those five or six companies, yes, whatever it is.

Q. Because there's another thing that's real apparent when you look at that, and isn't it fair to say that depending on what deal any purchaser—any person that's conducting a buy-out, leveraged or otherwise—depending on what kind of deal he can cut, that makes the premium? Isn't the premium the amount he paid over what the net worth of that stock is?

A. I wish it were that simple in the magazine business. It never seems to be.

(p. 106) Q. Well, sir—

MR. GEORGE: Please let him finish his answers.

THE WITNESS: I don't—I don't understand some parts of magazines, I guess. I don't understand why people put such high premiums on them but they do. A lot of it has to do with wanting to own it. A fellow by the name of Cy New'house bought *The New Yorker* at

an extraordinary multiple of earnings, and would I pay that much for that business? No. A fellow bought *U.S. News & World Report* for four times its then appraised value, five times its—or six times its previously appraised value on a book value that I think was around 23 million dollars, and he paid 59 times earnings for the business. Why did he do that? I don't know.

Q. Okay, sir. So then it's really fair to say that the fact that division of X Company was bought out at a 25 percent premium and Chilton Company up right above it was bought out at 231 percent premium—there's an intangible factor in there, and no one can figure out—you can't figure out, and you're the expert— can't figure out why there's a difference in (p. 107) these premiums?

A. Mr. Mendez, someone made a judgment on all of those companies. Someone made a judgment. They determined that this is the price they wanted to pay for it on an economic basis and, I believe, on an emotional basis. Why they arrived at that number, I can't deal—I mean, people do funny things. That's the number they arrived at, and that's what they paid, and rather than dealing with again a lot of psychological reasons why Cy Newhouse wanted to buy *The New Yorker* and have it in his publishing stable, these are the facts. ABC bought Chilton. It was a big publicly traded corporation. Why they agreed to pay a 231 percent premium for Chilton is beyond my comprehension, but as a practical matter they did. You can't change that.

Q. Is that the end of your answer?

A. I think you're—I don't know what you're driving at. These are indeed things that have occurred. They

are fact. They aren't figments of someone's imagination. I think there are, you know, any number of people in the State of Texas who would pay a large premium for (p. 108) the ownership of *Texas Monthly*. It's considered a very prestigious magazine in this state.

Q. So your testimony is that, regardless of what reason they might have had for buying them out at different prices on these premiums, you've taken an average, and you've applied that average, 191.2 percent, to *Texas Monthly*?

A. That's correct.

Q. And is it fair to say *Texas Monthly* is not a publicly held corporation?

A. *Texas Monthly* is not a publicly held corporation.

Q. And we don't know—you don't know what somebody might pay to buy it?

A. Neither was *U.S. News & World Report* a publicly held company.

Q. No, sir. I'm asking about *Texas Monthly*?

A. No, it's not a publicly held company. I can speculate on it, but by way of comparison, *U.S. News & World Report* was not a publicly held company.

Q. Okay. I just have a couple of questions left. Going back to that Maryland (p. 109) company, I don't remember what your testimony was, but I want to get it on the record. Was it your testimony that after your study was done on the solicitation effect or the effect on the

solicitation of that company of the tax—did it reduce circulation?

A. We made a judgment call that it had a negative impact on our circulation results, and we have a small circulation. So the percentages get to be more important, and we made a determination to pay the tax ourselves, rather than run that risk.

Q. Okay, sir, and you've testified today about your knowledge of some tests done by Texas magazines. Can you tell the Court the magazine names that were involved?

A. One was *Houston City* magazine published in Houston. One was *D Magazine* published in Dallas, and the other one was, of course, *Texas Monthly*.

Q. Okay, and are you aware of any other tests that might have been done?

A. Not specifically related to this state.

Q. Okay, and do you know if those (p. 110) companies are still operating?

A. All three of them are operating to my knowledge.

Q. And do you know how they decided to treat the sales tax or use tax?

A. Well, I think *Texas Monthly* has decided to—they would have to pay it out of their own pocket, and I'm not sure how the other ones have treated it at this point.

Q. Okay, and is it also your testimony that the Maryland company is still paying its sales and use tax?

A. It is paying a gross receipts tax right now.

Q. What gross receipts tax applies to that company, sir?

A. We get so much amount of the subscription revenues, and we take X percent of it as sales tax and pay it.

Q. What is the statute that specifies that there is an occupation tax on newspapers or magazines in Maryland, sir?

A. Mr. Mendez, I'm not a tax lawyer. I am not an Attorney General, but my God, you know, if it waddles like a duck and it quacks (p. 111) like a duck, chances are it's a duck.

Q. Is it your testimony that *Baltimore Magazine* is still paying its sales and use taxes in the State of Maryland?

A. Yes, it is my testimony they are still paying the State sales whatever tax in the State of Maryland.

Q. And is it your testimony that you're not aware of any gross receipts tax on the occupation of publishing magazines in the State of Maryland?

A. I am not aware of any, and the way we list it is the subscription price includes X amount and the sales tax.

Q. Okay, sir, and is it your testimony that that company is still in business in Maryland?

A. It is still in business in the State of Maryland.

MR. MENDEZ: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Very briefly let me go over a couple (p. 112) of things. First of all, data available on offices of magazine companies—is there a standard rate and data publication, a booklet or data base that shows information about magazine publishing companies?

A. Yes, there is.

Q. And who uses that?

A. Oh, primarily advertising agencies and other people who buy media. It lists mechanical requirements for the magazines. It lists circulation. It lists regional editions. It lists head operating personnel.

Q. Does it list where it has advertising sales—advertising agency—

A. I think it does.

Q. So if I'm a Dallas advertising agency and I want to put in an ad about the InterFirst Bank Holding Company, I could look in there and find out whether a regional edition of *Newsweek* is published and if they have a Texas office?

A. Yes, I'm almost positive you can.

Q. And in connection with the companies—I'm not going to ask you specifics, but in connection with—let's take the Washington (p. 113) Post Company, *Newsweek* publisher, the *U.S. News & World Report*. What's the range of fees you charge to those companies on an hourly or daily basis that they pay you?

A. Could I get off the hook by just saying excessive?

Q. If you could give a range of low to—

A. I do very little work by the hour, but I charge $350, if someone really insists on it.

Q. And that's for valuing magazine companies?

A. It could be for—for any number of things that they may call me in for.

Q. Now—

MR. GEORGE: Pass the witness.

RECROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Well, sir, you're familiar with the SRDS. Is there a compulsory set format to put things in the Standard Rate and Data Service?

A. I'm not sure what you mean by—

Q. When you submit information to the (p. 114) Standard Rate and Data Service, can you publish anything you want to from your rate card, or is there a standard compulsory format that you've got to fit into to get it on SRDS?

A. There's specific information they want you to list.

Q Do you know for a fact that it is a requirement of the Standard Rate and Data Service to require you to list all of your locations or offices on that publication?

A. Mr. Mendez, Standard Rate and Data is a publication. I think it's published monthly or quarterly. I don't recall right now. It is designed so advertising media plan-

ners have easy access to data on specific media, in this case, magazines, and a magazine would be foolish not to list all its advertising offices or all its offices. It wouldn't make any sense.

Q. Sir, I'm asking you if there is a requirement in describing or sending in an advertisement for Standard Rate and Date [sic] Service that you put in there what offices you have located throughout the world?

A. What they're listing in there isn't an advertisement. What they're listing is an (p. 115) editorial column basically on *The New Yorker,* for instance, and *The New Yorker* is going to want the advertising community at large to know where its advertising offices are.

MR. MENDEZ: Your Honor, we have no further questions at this point, but we may want to recall this witness at a point later during our case.

MR. GEORGE: I have no more questions.

THE COURT: You may step down.

MR. GEORGE: Can we put him on call at least?

THE COURT: How available would he be on call?

MR. GEORGE: I'm through with him but—

MR. MENDEZ: I've got some stuff back at the office that I want to show him and see if he can—

THE COURT: When do you want to do it? That's what we're trying to get—the time schedule.

MR. MENDEZ: Well, we'll (p. 116) do it sometime this afternoon. Well, I don't know when they're going to rest.

MR. GEORGE: I should rest before the lunch hour and he has—would like to get out of here this afternoon, if we arrange to cross him right after lunch.

MR. MENDEZ: We'll do it right after lunch.

THE COURT: All right. Be back after lunch then.

MR. GEORGE: We'd call Mary Mizwa.

(At this time instruments were marked as Plaintiff's Exhibits Nos. 54 through 56 for identification.)

MARY MIZWA

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Would you state your name and address for the record, please?

A. Mary Mizwa. I live at 1205 Cress in (p. 117) Houston, Texas.

Q. How are you employed?

A. I am the circulation director for *Southwest Art* magazine.

Q. And can you describe *Southwest Art* magazine?

A. It is a special interest publication with national distribution. It is what we call a prepaid publication. There is no billing of subscriptions.

Q. Okay, and is its home office in Texas?

A. Houston, Texas.

Q. I'll hand you what has been marked Plaintiff's Exhibit 54 and see if that's a copy of your publication?

A. Yes, this is our current issue, February.

MR. GEORGE: I offer Plaintiff's Exhibit 54.

MR. MENDEZ: Let me see if it has a thing in it that I was looking at before. No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

(p. 118) Q. Do you sell that magazine by subscription?

A. Yes.

Q. Okay, and do you have subscriptions sold to Texas residents?

A. Yes.

Q. Where is the magazine printed?

A. Houston—or the magazine is printed in Virginia.

Q. And is it trucked to Houston for mail to Texas residents?

A. Yes.

Q. By the printer?

A. The printer trucks it to Houston and delivers it to the post office where it's mailed.

Q. And do—have you added any instructions on your order form to ask Texas residents to pay sales tax?

A. Yes, we have.

Q. Okay, and what have you said?

A. We say, "Texas residents add a dollar sixty-eight sales tax" or in some instances a dollar sixty-nine. It's a rounded off number.

(At this time an (p. 119) instrument was marked as Plaintiff's No. 57 for identification.)

QUESTIONS BY MR. GEORGE:

Q. I'll hand you what has been marked Plaintiff's 57 and ask you if you can identify that?

A. Yes, this is a subscription offer that we ran beginning in our October issue, which was part of a Christmas offer.

Q. Okay. Is there a reference to the Texas residents add the tax?

A. Yes, add six and one-eighth percent sales tax on these particular ones.

MR. GEORGE: I'd offer Exhibit 57.

MR. MENDEZ: No objection, Your Honor.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Can you tell the Court how long you have been making an effort to get Texas residents to add the sales tax?

A. We began in October because all of our information was preprinted, and we waited until we reprinted, and when we reprinted we (p. 120) added the sales tax.

Q. Okay, and what has been the response?

A. Well, it's been a very poor—two percent is the most we've had respond to it.

Q. That is, of the orders you get from Texas residents, only two out of 100 people pay the sales tax?

A. Will pay the sales tax, right—a little over two percent.

Q. Have you produced a summary of those results?

A. Yes. This is our October and November results.

Q. And that's Plaintiff's Exhibit 55? You have to say verbally—

A. Yes.

MR. GEORGE: I'll offer Plaintiff's Exhibit 55.

MR. MENDEZ: No objection.

THE COURT: Admitted.

QUESTIONS BY MR. GEORGE:

Q. Is there any practical way for you to collect the tax from the people who don't pay the tax?

A. There is no way we can collect it (p. 121) because we do not bill, and it would just be prohibitive.

Q. For the price of the—

A. We don't have a computer program that sends—does invoicing.

Q. And the price of sending out a bill for 50 cents—

A. It would be too much.

Q. Now, I want to make this clear. They pay—

A. In advance—our subscribers. We do not bill at all, and we state that on the form. "Sorry. We do not bill."

Q. And so you have a subscription price of $27.50?

A. That's right.

Q. And your—98 percent of the people send in the purchase price but not the tax?

A. That's right.

Q. And—

A. The only ones that we get—that we have any option at all of collecting tax from are those who pay by credit card, and on the credit card sales we add the tax.

Q. You just add it to their bill?

(p. 122) A. We add it to it. That's right.

Q. And do they make outcry when they get their bill?

A. Yes, we had quite an outcry.

Q. They don't know that when they—

A. No, they don't know that when they give us the credit card number.

Q. And how many of your bills are credit card?

A. Our credit cards really run depending—around Christmas time we had more, but average is around 20 percent of our subscription payments.

Q. And how much of your total circulation is by subscription?

A. Our total circulation?

Q. How much is newsstand, and how much is subscription?

A. Well, about 44,000 is paid subscribers, and around 9,000 is newsstand.

Q. So the subscription sales is the vast majority of your sales?

A. Yes.

Q. Okay. I'll hand you Exhibit 56 and ask you if you can identify that?

(p. 123) A. Yes. This is our state by state breakdown, which we did for the latest ABC audit report.

MR. GEORGE: Okay. You've seen this, Counselor?

MR. MENDEZ: Yes, sir.

MR. GEORGE: I'll offer Exhibit 56.

MR. MENDEZ: No objection, Your Honor.

THE COURT: Admitted.

MR GEORGE: Pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Ms. Mizwa, we talked on the phone the other day, didn't we? Okay. Now, what was your previous response rate to your insert cards before you changed to this—to adding the Texas sales tax?

A. Well, we haven't noticed any appreciable difference in the response. You mean to our bind-in cards?

Q. Yes.

(p. 124) A. None.

Q. Okay. Now, you mentioned that there was a two percent response rate to one of the documents. Which one of the ones was the one that you had?

A. Well, that was our—the two percent response was, I believe, in November. In October in the first month it was just a little over one percent.

Q. And those are persons—that's your net response of persons that subscribe to your magazine?

A. The Texas residents.

Q. That—

A. That pay the tax.

Q. Okay. In their orders that are for your—

A. In their cash they added the sales tax.

Q. Okay, and now did you use this type of subscription offer before November?

A. Yes, we've used the same type bind-in card consistently.

Q. Okay. Now, before you added in the language about the sales tax—let's say, the (p. 125) month before that, do you have any records as to what the percentage response was to these bind-in cards?

A. I do but I don't have it with me. It would also be hard to judge because the time we did the new one it was a whole new promotion, and our history is that when

we do a new bind-in card we get a better response the first two months. So it would be hard to judge.

Q. Okay. Now, what's the percentage of circulation that you have in Texas as compared to your total circulation?

A. 23 percent.

Q. Okay, and how much of that is by subscription?

A. How much of that 23 percent?

Q. Of that 23 percent is by subscription?

A. Oh, I forget. May I look at that? I just did these new numbers. Just a moment. Of that 10,000, 403 are Texas subscribers, and 2,500 and—I'm sorry—2,356 are newsstand, and we have a total subscription in Texas of 12,759.

Q. Now, ma'am, how long have you been (p. 126) publishing—how long has the company been publishing that magazine?

A. 14 years. We're staring our 15th year in May.

Q. Okay, and what kind—what's the demographic profile of persons that you attempt to sell this magazine to, if you have any defined group?

A. Well, our advertising department says they're Reaganites, if that means anything.

Q. Okay, and have you made a business—

THE COURT: Rich? Is that what you mean?

QUESTIONS BY MR. MENDEZ:

Q. Now, do you know that persons that might subscribe to *Texas Monthly* might subscribe to your magazine?

A. Yes, we are getting some cross over because they do have what's known as yuppies, and those are a new group that we've gone after with some campaigns lately. So we would have some cross over readership.

Q. These are people that want to be rich, and they're working on it?

A. They're spending their money— (p. 127) maybe not saving any.

Q. Well, ma'am, were you with this publication back prior to 1977?

A. No.

Q. Okay. Do you have any idea whether or not *Southwest Art* collected sales and use tax back before 1977 when the subscription exemption came into place?

A. No, I have no knowledge of any of that.

Q. Now, ma'am, I guess it was a business decision of the corporation to add that language into your binding cards; is that correct?

A. Yes, it was a business decision after we realized how much we would have to pay if we did not add it.

Q. Okay, and I guess—have you made any decisions, based on the responses that you're getting of collecting this tax, to whether or not to maintain that language in your insert?

A. We probably will not because we're collecting so little of the money, and the philosophy in subscription sales is to make the (p. 128) offer as uncomplicated as possible, and even though we have even stated the exact amount, we don't seem to have any luck. So—

MR. MENDEZ: Pass the witness.

MR. GEORGE: I have no further questions. Thank you very much for coming.

THE WITNESS: Thank you.

MR. GEORGE: We would—may she be excused from the rule?

THE COURT: You may be excused.

MR. GEORGE: We would rest at this point in time.

THE COURT: All right. Then we'll take our noon recess then, unless you've got something short you want to put on.

MR. MENDEZ: No, sir, Your Honor, I'd rather wait, if you don't mind.

THE COURT: All right. We'll start up at 1:15 then, since we're recessing this early.

(At this time a lunch recess was taken, after which time the (p. 129) proceedings continued as follows:)

MR. MENDEZ: If we may, Your Honor, sort of before we begin our presentation, I want to recall Mr. Lepere so he can get out of here.

THE COURT: All right.

(At this time there was a brief discussion off the record.)

RICHARD L. LEPERE

was recalled as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Lepere, you were stating that *Texas Monthly* publishes its rate card and some of its information in the Standard Rate and Data Service, and that that's a document that advertisers might use; is that correct?

A. That's correct.

Q. Okay, and just so that the Court can get an idea of what that publication might be like, I'm going to hand you a document which Mr. George has been looking over, which is—and (p. 130) could you identify that document? I'm not having it marked.

A. Well this is the Standard Rate and Data for newspapers, which covers newspaper rates and mechanical data and production data.

Q. Okay, sir, and is that a document commonly used in your industry?

A. No, we use the one that is—what is referred to as the SRDS for consumer magazines and foreign publications is the category.

Q. Okay, sir, and is that type of—does it look something like that document?

A. Yes, very similar.

Q. Okay, and could you explain for the Court what's in the magazine SRDS—what type of information one would put in there?

A. Well, there's—here is the information on *The Huntsville Times*, which is a Newhouse newspaper in Huntsville, Alabama. It has the times it's published—evening and Sundays. It's got the names of some of the personnel—the editor and publisher, the marketing manager. It's got the representative of the branch offices of Newhouse newspapers. (p. 131) It's got the commissions and cash discounts to agencies. It's got sort of an all policy classification. I'm not sure what that is. I'm not that familiar with newspapers. It has the advertising rates effective April 1st, 1984, effective February 13th, 1984, and then it proceeds to give the advertising rates for the different editions. It has color rates and data—when they can accept color. When they can't accept color. It has split run, which is when you want one ad to appear in certain parts of the paper and another ad to appear in another portion. It's got mechanical requirements. It doesn't have copy and contract regulations. It directs you to somewhere else. It's got mechanical measurements.

Q. And sir, would it be fair to say that that's a type of information that you have in a magazine SRDS?

A. Yes, it's similar.

Q. Okay, and I guess the one point I wanted to—for you to see if you could agree with me on is that it may or it may not contain information about those com-

panies' locations, warehouses, distribution points in any (p. 132) particular state?

A. Mr. Mendez, it is highly unlikely that *The Huntsville Times* is going to be soliciting advertising in Dallas, Texas.

Q. Well, sir, what I'm asking you is in a magazine SDRS—and you had stated that that publication would have this type of information. I'm asking you if you can agree with me that it might for any particular magazine—and we're talking generically and in there—anything that's published in SRDS for magazines—that it might or it might not have a list of every facility that that company has in any particular state?

A. We never discussed any facility. We discussed advertising and sales offices.

Q. Well, I'm asking you can you agree with me that it might or it might not?

A. It is not going to list the facility in SRDS. If they happen to have a warehouse in Tuscaloosa, Alabama, it's not going to list it. It may list advertising sales offices, which is what the purpose of this is.

Q. That's what I wanted to get at. Are you familiar with the Ayer Directory?

(p. 133) A. Yes, I am.

Q. Okay, and do you know if *Texas Monthly* is published in that?

A. I do not. I have not looked at it for a number of years.

Q. If I handed you a page from the Ayer Directory, would you be able to identify it just by looking at it—any particular page?

A. Most likely.

MR. MENDEZ: Okay. I'm going to have this marked as Defendants' Exhibit No. 2.

(At this time the instrument referred to was marked as Defendants' Exhibit No. 2 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. Now, sir, I'll hand you what has been marked Defendants' Exhibit No. 2. Does that look like a page of the 1984 Ayer Directory?

A. It says at the top, "IMS '84 Ayer Directory of Publications."

Q. And from your experience with this publication, does this look like it's from there?

A. Yes, it does.

Q. Okay, and does it state *Texas* (p. 134) *Monthly* in there?

A. Yes, it does.

Q. And what information does it give you about *Texas Monthly*?

A. It gives name, the way it's printed, offset, established 1973, monthly, general interest, black and white page rate, four color rate, columns, widths and depths, subscription rate, name of the editor, name of the publisher, name of the advertising director, and that's it.

Q. Okay, and it states—

A. And circulation. Excuse me.

Q. And it states its location in Texas; is that correct?

A. Actually it has Post Office Box 1569 and then a zip code. It never says exactly where it is.

Q. And it doesn't state anywhere on there about its advertising offices in any particular—

A. But it wouldn't. That's not what this directory is for.

MR. MENDEZ: I'll pass the witness.

MR. GEORGE: I don't have (p. 135) any more questions for Mr. Lepere. May he be excused?

MR. MENDEZ: I don't have a problem.

THE COURT: Thank you. You may be excused.

MR. GEORGE: You're welcome to sit in the courtroom or go catch your airplane.

MR. MENDEZ: We'll offer that exhibit, Your Honor.

MR. GEORGE: No objection.

THE COURT: Admitted.

MR. MENDEZ: Before we start our witnesses, Your Honor, if I may, if I can diagram something of what we're going to be doing so you can—

THE COURT: Surely.

MR. MENDEZ: Your Honor, what we're going to show you, starting this afternoon and hopefully finishing

as soon as possible, is what the Comptroller does and how he does his work. Throughout the course of the plaintiff's case, there have been some witnesses called, and they've been asked questions about (p. 136) specific tasks and what their relationship is to that. What we're going to show you now is how the Comptroller goes about dealing with these problems, and we're going to show you, I think, that he has a limited set of resources that he has to allocate in the wisest way, and that's what the Legislature gave him to work with, and he tries to use it as effectively as possible.

We're going to be talking about three groups of people. Tax administration is one group of people, and we're going to put a witness on to explain what they do, and then we have another group that is the enforcement group, and we'll explain how they get out there and collect taxes and find people that owe taxes or might owe taxes, and of course, our audit.

Superimposed on all of this—on these three areas—and I'll be filling in as we go through it—will be evidence about new tactics that the Comptroller has taken that you may have heard about in the paper and on television that will relate to how to do this type of work—tax collecting, as to out of state, non-permitted sellers of goods (p. 137) into the State of Texas, and there will be two or three different kinds of those sellers—people that don't have nexus and people that have nexus and people that we're having trouble finding, and so with that in mind, we'll call our first witness, who is Wanda Hutcheson.

WANDA HUTCHESON

was recalled as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Now, Ms. Hutcheson, you gave testimony yesterday in this case, did you not?

A. Yes, sir.

Q. And you were asked about a lot of things that you didn't do. So now we know what you don't do. What I'd like for you to tell the Court this afternoon is what does the Tax Administration Division of the Comptroller's office do? What are its functions, and then we'll move on to the policy section.

THE COURT: Let's keep it short and brief and general. I don't want to (p. 138) try this lawsuit—because I'm sure there's enough that you could bring in your testimony to what the Comptroller does that will be irrelevant. Let's keep it relevant.

MR. MENDEZ: Yes, sir. That is exactly what we're trying to do.

QUESTIONS BY MR. MENDEZ:

Q. What does the—can you explain the function of the Tax Administration Division in enforcing any of the —the sales and use tax?

A. Well, tax administration basically is in—separated into three areas. You've got taxpayer assistance.

That section normally makes up our phone bank, and they are the people who answer sales tax questions from the public on—as well as other franchise tax and other taxes, but they do answer tax questions from the public.

Q. Okay, and with respect to this phone bank, is that your 1-8[illegible] number that's available to persons throughout the state?

A. Yes, sir, it is.

Q. And if someone had a question about his or her use tax liability for a magazine, would they be able to contact this phone bank (p. 139) and get information about that—the policies of the Comptroller's office with respect to use tax?

A. Yes, sir, they would. If it was established policy, the taxpayer assistance group should have that information, yes, sir.

Q. Okay, and is the—that 1-800 number published throughout Texas?

A. Yes, sir, it is.

Q. Now, does that phone bank also have fixed—foreign exchange lines to various cities in the state so that people can call their local number and get somebody here in Austin to talk to on the phone bank?

A. Yes, sir, that's correct.

Q. Now, and anybody that—would anybody that called on that phone bank and asked about his use tax liability as a consumer have been told not to file a return?

A. Has anyone been told not to file a return?

Q. Yes.

A. Not if it's an item subject to sales tax being discussed, no, sir.

Q. And if someone wants to voluntarily (p. 140) remit taxes and identifies themselves as such on this—to this phone bank, would they explain how to get a permit or how to file that money?

A. If a person had use tax to report, they would be told how they could turn it in, yes, sir.

Q. Okay. What other divisions does the Tax Administration Division have?

A. Well, we have a support group called office management, and they help with the forms. They help with small computer runs—that sort of thing in support of the other two divisions.

Q. Okay, and what is the other division?

A. And then finally we have the tax policy section, the one that I'm most familiar with.

Q. Okay, and you are the supervisor?

A. Supervisor of the sales tax policy, yes, sir.

Q. Okay, and could you describe for the Court briefly what types of things tax policy is responsible for?

A. Well, I think our primary concern is answering sales tax questions from both permitted taxpayers and from consumers. We'll (p. 141) answer telephone—questions by telephone. We'll answer them by letter. We answer questions from field personnel, permitted taxpayers

and consumers. We write sales tax rules. We issue policy statements. We assist our legal services division in writing their positions to—what we call position letters when a person has been audited and is going to reach determination hearings.

Q. Would you train individuals in the Comptroller's office as to what the policy was?

A. We do extensive training. We make speeches. We have a training center in Kerrville that we provide subject matter experts for.

Q. Okay, and do you review any of the publications that might go out from your agency that have information about substantive law or the substantive tax?

A. Anything to do with the sales tax—we would review it before it went out to be sure that the information was correct and current, yes, sir.

Q. Okay. Would you have an occasion to make video tape presentations that are available (p. 142) to the rest of the agency that can be used on substantive policy or on procedural policy?

A. We have assisted in video tapes and in radio commercials—I mean, radio spots also.

Q. Okay, and is all of this to try to get the information out to the rest of the people in your agency?

A. To be sure that everyone is being given the same information and that the information is current, yes, sir.

Q. Now, let's say that somebody called the tax assistance group and had a difficult question about sales

tax. Would those types of questions be referred to policy, or would they be referred to some other group?

A. They would be referred to policy, yes, sir.

MR. MENDEZ: Okay. At this point I'd like to have some exhibits marked, Your Honor.

(At this time instruments were marked as Defendants' Exhibits Nos. 3 through 11 for identification.)

QUESTIONS BY MR. MENDEZ:

(p. 143) Q. Ms. Hutcheson, I'm going to hand you a group of exhibits, and we'll go through them in order. We'll start with No. 3. Can you identify that exhibit?

A. Yes, sir. That's a reprint of the Limited Sales Excise and Use Tax Act with the changes made by the special session in the last session of the Legislature included.

Q. Okay. Did the Tax Administration Division get that—review that and make sure that it has all of the statutes on sales and use tax?

A. Yes, we did.

Q. Okay. Is that document available through the Comptroller's office to anybody that asks for it?

A. Anybody that wants it can have a copy, yes, sir.

Q. Okay, and if you go out and do a speech to a group of, let's say, publishers, would you haul a group of those sales and use tax statute books with you and hand them out?

A. If we thought it was appropriate, yes, sir.

Q. Okay. I'm going to hand you a copy (p. 144) of what's been marked Defendants' Exhibit No. 4. Can you identify that document?

A. Yes, sir. That is Rule 3.346 of our use tax rule.

Q. Okay, and did you promulgate that in accordance with the rules of—the Texas Administrative—

A. Procedures Act.

Q. Yes.

A. Yes, we did.

Q. Okay, and is that rule published and available through the Comptroller's office?

A. Yes, it is.

Q. Okay, and that's in the same way that the statute book is, is it not?

A. Yes, sir, and it's available in this form to anybody that wants it.

Q. Okay, and does that inform taxpayers of their obligation to pay use taxes?

A. Yes.

Q. And I have a document here which has been marked Defendants' Exhibit No. 5. Could you identify that document?

A. This is a document that we prepared—or that was prepared right after the special (p. 145) session. It was prepared mainly for the Texas State Fair in Dallas, and then it was sent to all of our field offices so that the public could have some information on the new taxes.

Q. Okay, and did you help prepare that document?

A. Yes, sir, we did.

Q. Okay, and you say that that was made available at the State Fair to all consumers that were out there?

A. That's correct.

Q. What does it say about magazine subscriptions in that publication?

A. It has one sentence about magazines. It says, "You now pay sales tax on newspaper and magazine subscriptions and over-the-counter sales."

Q. Okay, and now I hand you what's been marked as Defendants' Exhibit No. 6. Can you identify that document?

A. Yes, this is the sales tax review—the October 2nd, 1984 edition, and this was a publication that was prepared and mailed to all persons who hold—who held Texas sales or use tax permits in October of 1984.

(p. 146) Q. Okay, and Ill hand you as a group Defendants' Exhibits 7 through 10, a group of brochures. Could you further identify those documents?

A. Exhibit No. 7 is a brochure entitled the Texas Use Tax. No. 8 is a brochure entitled Sales Tax Permit, No. 9, Boat Dealers and Buyers, and No. 10, Texas Tax Deadlines.

Q. Now, ma'am, are those again documents that you've reviewed and for substantive policy in your office?

A. Yes, that's correct. These are the type brochures that we do review and do have printed.

Q. Do you have knowledge as to where these documents are put or sent?

A. They're available at all of the field offices in the area. We have some at—we did have. I'm not sure now whether we do or not but we did have some at all of the courthouses—anyplace that the public can get hold of them.

Q. Okay, and it states that—there's a use tax one in there. Does it contain information about when you have use tax (p. 147) liability?

A. Yes, sir, it does.

MR. MENDEZ: I'll offer Defendants' Exhibits 3 through 10.

MR. GEORGE: No objection.

THE COURT: Admitted.

MR. GEORGE: Can I see those, please?

QUESTIONS BY MR. MENDEZ:

Q. So does—is the phone bank available for use by enforcement officers that might not understand a particular policy point, if it comes up in the field?

A. Yes, sir, the enforcement people and the audit people are aware of the phone bank. They can call either the phone bank or policy when they have questions.

Q. Okay, and now, there was some testimony that you gave yesterday—well, before we go to that, is it your responsibility to go out and find taxpayers that may need permits?

A. No, sir, it is not.

Q. Okay. Is it your responsibility to examine taxpayers' records to determine if they (p. 148) have an audit liability?

A. No, sir, it's not policy's responsibility.

Q. So if somebody asked you why you hadn't gone to check on some Boy Scout Troop or Girl Scout troop about their sales tax liability, is that something that's within the scope of your employment?

A. No, sir, it is not.

Q. Is it your understanding that there may be other people that do that job?

A. There are other people in the agency whose job that is, yes, sir.

Q. Now, you were a member of the tax policy committee, and you testified about that yesterday—what the tax policy committee didn't do. Could you explain what it was created for and who created it?

A. Right after the special session we were beseiged with questions from taxpayers who were affected by the changes in the special session. So to ensure that the answers all came from the same place and that we could have some control of what the answers were given and that they were consistent and correct, Mr. Bullock (p. 149) formed the policy committee, and the policy committee was there for the purpose of answering questions on the law, and if a particular group came in with a question—a particular question on their responsibilities, we were there to respond to specific situations.

Q. Okay. Were you supposed to make decisions about all of the use tax or just the use tax changes that had come into effect?

A. The policy committee formed at that time was only for the special session.

Q. Okay, and how many different problems—can you identify how many different tax changes there were in the statutes that the committee might have dealt with?

A. I can't give you a specific number because they were numerous. We're still discovering areas that are under the new tax that we weren't aware of at that point in time.

Q. Okay, and did you-all consider magazines as a group—magazine publishers as a group in any of these meetings and decide one way or the other whether or not they were taxable or how they were to be treated for administration purposes?

(p. 150) A. No, sir, we did not.

Q. Okay, and was the policy committee responsible for checking out school children or, you know, Girl Scout troops to determine if they were liable for taxes?

A. No, sir. The only connection we had with groups of that sort—if someone asked if what they were—the specific activity they were engaged in—whether or not that activity was taxable, we would respond that it was taxable or it was not taxable, but that was as far as our responsibility went.

Q. Was there any change in the nexus law during this special session?

A. No, sir.

Q. So did the committee have to address any issues of nexus or what constitutes doing business in Texas?

A. No, sir.

Q. Okay. Now—so when Mr. George asked you about verifying those numbers that Mr. Gerhart had given to you and you said that you hadn't verified them, is that a job that's normally within the scope of the policy committee or within the job of the sales tax (p. 151) policy group?

A. I guess I don't remember what numbers you're talking about.

Q. Well, did you have some meetings with Mr. Harry Gerhart?

A. Yes, we did.

Q. Okay, and at one of those meetings did Mr. Gerhart identify to you the potential amount of sales tax that he thought should be collected from certain taxpayers that he identified to you?

A. That could have happened at the first meeting. I was more—an observer at the first meeting than I was a participant, and I think that he did provide some information of that sort at the first meeting.

Q. Did you do anything with that information?

A. With that information, no, sir, I did not.

Q. Is that part of your task in the tax policy committee?

A. No.

Q. And in your role in the Tax Administration Division?

(p. 152) A. No, sir, it's not.

Q. Okay, and you took some lists from Mr. Gerhart at one of these meetings?

A. The second one, yes, sir.

Q. Okay. Did you do anything with those lists?

A. Yes, we did.

Q. Okay. Could you explain for the Court what you did with the lists after you got them?

A. We—when we decided to send out letters to the taxpayers listed on that—on that list that Mr. Gerhart provided, we did run some—run those names through our computer to see if some of those people already had permits so that we wouldn't send letters out to people who were already permitted.

Q. And what did you determine from that cross check?

A. Well, we did find some of those people on those lists that already held sales tax permits and were already remitting tax.

Q. Okay. Did you contact the rest of those people?

A. We sent out 76 letters, yes, sir.

(p. 153) Q. And what was your experience with respect to those letters?

A. All right. Now, those letters went out to people that Mr. Gerhart indicated might have representation and those that he thought did not have. I don't have a breakdown of the two, but we did send out a total of 76 letters, and we got 21 responses, either verbal or in writing.

Q. And the other 50 or so people did not respond?

A. Did not respond, no, sir.

Q. Okay. Did you follow-up on those anyway?

A. No, sir, we got—we got two applications in plus one letter stating that they were already reporting tax and gave us the number under which they were reporting. The rest of the people said that they did not have any contact or representation in Texas, but we did not follow it up—any of the rest of the letters.

Q. Did you send a letter to *Reader's Digest?*

A. Yes, we did.

(p. 154) Q. Okay, and I'll hand you what has been marked Defendants' Exhibit No. 11. It that the letter that you received from *Reader's Digest* in response to your mail-out?

A. Yes, it is.

Q. Could you read that first couple of sentences to the Court, please?

A. "In reference to your attached letter, please be advised that we are not engaged in business in your"—

MR. GEORGE: Excuse me, Ms. Hutcheson. Just for appearance sake, I would appreciate it if the exhibit was offered before it was read. I am going to object to the

reading of the exhibit before it's been offered. If you want to offer the exhibit, I will say I have no objection—

THE COURT: Why don't you offer the exhibit, Counsel?

MR. MENDEZ: We'll offer the exhibit. Well, let me see.

QUESTIONS BY MR. MENDEZ:

Q. Is that a record that you keep in your office?

A. Yes, it is.

(p. 155) Q. Okay, and that's—and you brought this over to us today; right?

A. Yes, we did.

MR. MENDEZ: Okay. I'll offer Defendants' Exhibit 11.

MR. GEORGE: I don't have any objection.

QUESTIONS BY MR. MENDEZ:

Q. Could you read the first couple of sentences to the Court?

A. "In reference to your attached letter please be advised that we are not engaged in business in your state. Under National Bella Hess our mail order sales are not considered taxable. We do not have offices, inventory, warehouses or people who maintain any of these items. Please adjust your records accordingly."

Q. Thank you. Now, do you—

THE COURT: Has this been admitted? You didn't have any objections?

MR. MENDEZ: [sic] I have no objection.

THE COURT: All right. Admitted.

QUESTIONS BY MR. MENDEZ:

(p. 156) Q. Now, with respect to this particular corporation, Ms. Hutcheson, do you have any further duties in the Comptroller's office or in the Tax Administration Division, as far as dealing with that company?

A. No, we do not.

Q. Okay, and if some other division might later try to contact them or attempt to audit them, that would not be a function of your office?

A. That is correct. It would not be a function of tax administration or tax policy.

Q. Are you familiar in your work with the Tax Administration Division, of any situations where persons might voluntarily remit tax?

A. Yes, they have voluntarily remitted tax before.

Q. And you've sat here and heard some testimony about situations of voluntary remittance. Could you explain what vehicle there is where some consumer can come in and remit these taxes?

A. If it's a one-time event—if they only have the use tax to report one time, we (p. 157) just tell them to turn it in. If they're going to have use tax on a continuing basis, we set them up so that they will get report forms on a regular basis so that they can report that use tax to us.

Q. Now, you've listened to testimony yesterday and today about how *Texas Monthly* magazine is delivered to Texas residents. If *Texas Monthly*—this is a hypothetical, let's say. If *Texas Monthly* delivered a magazine to you in Lockhart pursuant to a subscription sale, how much tax —what tax rate would apply to that sale?

A. In Lockhart it would be five and one-eighth.

Q. Is that the amount that *Texas Monthly* would have had to report on its sales and use tax return?

A. Yes, that's correct.

Q. Now, if they delivered the magazine to Red Rock, Texas, which is not on that list of tax—

A. Assuming Red Rock does not have local tax—city tax?

Q. Yes. How much would they have to—

(p. 158) A. Four and one-eighth.

Q. Okay. Now, if *Texas Monthly* could show you by zip code or otherwise that they were delivering a certain number of their magazines to places in Texas where they didn't have representation—and we're assuming they didn't have representation in Red Rock or in Lockhart—then would they have to pay at the Austin tax rate?

A. No, they would not.

Q. So to the extent that they might have delivered magazines to consumers in cities that are outside of Austin, then they might or might not have overpaid taxes?

A. That's correct.

Q. Okay, and if they had asked you—if *Texas Monthly* had asked you or your staff as to how to calculate the amount of tax for any particular individual, is this the policy that would have been disseminated to them?

A. Yes, it is.

Q. Okay. Do you know if they've asked what rate to apply to their report?

A. We may have discussed it. I'm not sure.

(p. 159) MR. MENDEZ: We'll pass the witness.

MR. GEORGE: Ms. Hutcheson, let me ask you a couple of things quite briefly, I hope.

(At this time there was a brief discussion off the record.)

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Ms. Hutcheson, we're talking about two issues—three issues that involve you in this case. Let's talk about one as collection from out of state publishers, okay?

A. Yes, sir.

Q. You understand, don't you, that people who do business in Texas under the definitions in the statute are obligated to collect the use or sales tax from Texas readers?

A. Yes, sir.

Q. You know that for a fact?

A. Yes, sir.

Q. And you know that there is a statutory definition of what constitutes doing buisness in Texas, don't you?

(p. 160) A. That's correct, yes, sir.

Q. And you know that that's contained in Section 151.107, don't you?

A. Yes, sir.

Q. And in that section there's two paragraphs, A and B?

A. Yes, sir.

Q. And A has to do with warehouses and the like, inventories in the state?

A. That's correct.

Q. And B, however, says you have respresentatives soliciting orders, doesn't it?

A. Yes, sir. Actually it's number two but—

Q. Number two. I'm sorry.

A. —the spirit of the thing is correct.

Q. Two?

A. Yes, sir.

Q. Subsection two of Section 151.107 in the tax code?

A. Yes, sir.

Q. And it says that's doing business in this state?

A. That's correct.

(p. 161) Q. And you got that letter from *Reader's Digest* when?

A. August 7th, 1985.

Q. Okay, and that's—since August 7th—that's about five months ago—you knew at that time that they had people soliciting orders in this state, didn't you?

A. No, sir, I did not.

Q. You were told by Mr. Gerhart in the fall that there was a general practice of having school children go door to door to solicit orders?

A. He did say that, yes, sir.

Q. Okay, and you believed it. You wrote Mr. Castlebury a memo saying that that was probably right?

A. What he said—I gave Mr. Castlebury a report on what he said, yes, sir.

Q. And you told Mr. Castlebury that those people were in the state, and you knew from your own experience because people would come to your house you told me on deposition?

A. That's correct.

Q. That people came to your house soliciting advertising—soliciting (p. 162) subscriptions?

A. For magazines in general, yes, sir.

Q. Yes, ma'am, and you—let me put it this way, Ms. Hutcheson: You certainly had good reason to believe that *Reader's Digest* had people soliciting orders in this state, didn't you?

A. I had no reason to think they did or did not. I had—I didn't think about them one way or the other.

Q. You knew that there was a general practice of people making door to door solicitations for advertising?

A. That's correct.

Q. For subscriptions to magazines, and you knew that there was a general practice of having school kids solicit them in Texas?

A. Yes, sir.

Q. And you knew those facts, and on August 7th you got a letter from *Reader's Digest* saying, "I don't have any inventories, and I don't have any warehouses, and I don't have any offices. So I'm not going to pay you any tax;" right?

A. That's correct.

(p. 163) Q. And you did absolutely nothing to see if the paragraph two of Section 151.107 was applicable to that company, even though you knew those other facts about the widespread use of soliciting agents in the state by magazines, and you had subscribed to *Reader's Digest* yourself?

A. That's correct.

Q. You didn't do anything about that?

A. That's correct.

Q. Okay, and you didn't report it to Enforcement Division?

A. We did not.

Q. You didn't report it to Audit Division?

A. We did not.

Q. You didn't do anything?

A. That's correct, we did nothing.

Q. That's right, and that's the general practice, isn't it? You've done nothing to this obligation for publishers up here—this part. *Texas Monthly* is supposed to collect, as required and forced to collect the tax, but *Reader's Digest* isn't, even though you have very good reason to know that they have solicitors in this state?

(p. 164) A. I have reason to know that there are solicitors within the state. I have no knowledge whatsoever that they belong to *Reader's Rigest.*

Q. You don't know that *Reader's Digest* has people—I'm not going to go further. We know that you know there's solicitors. We know that *Reader's Digest* is in the state. You know it's a widespread practice, and you know you subscribe to *Reader's Digest,* but knowing those facts, you went no further. You just ignored all of those facts and didn't do anything about it?

A. I did not go any further, that's correct.

Q. All right. So *Texas Monthly* has to do this. *Reader's Digest* doesn't, and you've done nothing else to find out anything about *Reader's Digest's* obligations; correct?

A. That's correct.

Q. All right. Now, there's a second problem in this case. It's consumers pay tax themselves. That's their obligation, too?

A. That's correct.

Q. Okay, and I believe on deposition (p. 165) you told me that that was a widespread practice to ignore that obligation?

A. I don't know how widespread it is. I know that I have ignored it.

Q. Okay, and you believe it's generally ignored by most people in this state?

A. Yes, I do. I believe that.

THE COURT: I think I can take judicial knowledge of that now.

QUESTIONS BY MR. GEORGE:

Q. Okay, and this is the second—these are two different obligations, and this one is just as much the law as that one?

A. Yes, sir.

Q. Okay. Now, in connection with this issue, you have told us the Comptroller has a system to collect money without any forms to be processed—

A. That's correct.

Q. —without any returns to be processed, without anything else, doesn't it?

A. Without any of those items being done by consumers, that's correct—without the forms being filled out or anything by consumers—

Q. Well—

(p. 166) A. —that's correct.

Q. —bring you money?

A. They just hand it to us, and we give them a receipt.

Q. And that's net money. I mean, there's no cost of administration then, is there?

A. At that point, no, sir, but getting the money on the system there's a cost.

Q. You have to put it in the bank?

A. Among other things.

Q. Okay, but in connection with this system, the only thing you've done to inform people of the obligation or to encourage voluntary compliance—the only thing that is directed to people who don't hold permits that are not in business is to pass out a brochure with one sentence in it at the State Fair?

A. Well, if you discount the brochure on use tax that they have available to them and the rule on use that is available to anybody who needs it.

Q. Yes, ma'am. Let's look at the brochure on use tax, which I have lost. What did I do with it? There it is. Now, let's look at that.

(p. 167) MR. GEORGE: May I approach this witness?

QUESTIONS BY MR. GEORGE:

Q. There's an example about what—how the use tax applies, and bunches of examples, aren't there, in this—several examples in this exhibit?

A. Yes, sir.

Q. The first one has, example, Mary Doe Company orders a printing press. That's a business example, is it not?

A. Yes, it is.

Q. The next example is B&R Construction Company orders cypress paneling from Florida. That's a business example, isn't it?

A. Yes, it is.

Q. Example three, Doe Company in Austin sends its answering machine to be repaired in Ohio. That's a business example, isn't it?

A. Yes, it is.

Q. The third one is a Houston repairman orders equipment from New York. That's a business example, isn't it?

A. Yes, sir, it is.

Q. You have—the next example is a (p. 168) California office furniture company has a liquidation sale in November. A Texas company buys 20 desks. That's a business example, as well, isn't it?

A. Yes, sir, that's correct.

Q. The next one is Sam Feather, a direct payment permit holder, buys 200 cases of motor oil from a Texas seller and issues a valid direct pay exemption. That's a business example, too, isn't it?

A. Yes, that's the example of a business that pays tax directly, yes, sir.

Q. And Creighton Corporation of Texas sells three forklifts to a subsidiary in Texas, and that's another business example?

A. That's correct.

Q. And finally you have Farmer Brown orders a tractor. Now, that's kind of a business example, but in that example you tell him no use tax is due because there's an exemption?

A. Because there's an exemption, yes, sir.

Q. And of all of the examples that if a consumer gets this brochure, there's not one (p. 169) example—one word about regular consumers' obligations to pay the tax, is there?

A. That's correct.

Q. And there was no additional cost, would there have been, to put in an example about you go to Bloomingdales and you have them send you things and you can have—and you owe use tax on that? That could have been included?

A. Yes, it could.

Q. And you chose not to?

A. Yes, sir, that's correct.

Q. Now, the statute book I handed you before gets distributed to people, does it not?

A. Anyone that asks for it, yes, sir.

Q. And this contains the exemption for religious publications, does it not—religious periodicals?

A. Yes, sir, that's correct.

Q. And it is used to inform people that if a periodical contains holy or teachings sacred to the faith and published by a faith it's exempt from tax?

A. That's correct.

Q. And your job is to advise people about that exemption?

(p. 170) A. Anyone that asks us, yes, sir.

Q. And you have done that?

A. Yes, sir.

Q. And you know, as you testified earlier, that those publications exist?

A. Yes, sir.

Q. And you go about applying that exemption under the terms it's written, do you not?

A. Yes, sir.

Q. And you have the obligation, at least under the statute, to determine whether the teachings are or are not sacred to the faith and whether they are not—whether the content of those—that magazine, that periodical comes within the exemption—whether what the words are come within the exemption. That's what the exemption says, and it's your obligation to inform people about that?

A. That's what the exemption says, yes, sir.

MR. GEORGE: Pass the witness.

REDIRECT EXAMINATION

(p. 171) QUESTIONS BY M. MENDEZ:

Q. Well, Ms. Hutcheson, do you have a budget to publish these brochures? Is there money appropriated by the State Legislature to provide these kinds of documents?

A. Yes, sir, there is.

Q. And is there a reason why you might make brochures for a specific area, as opposed to just a general brochure?

A. Well, we direct them at where we will probably get the most money.

Q. Okay, and there's a brochure on boats, I think, that I handed you? I'm not sure.

A. Yes, sir, there was.

Q. Let me see. Where's the rest of them? What is that entitled?

A. That's a brochure entitled Boat Dealers and Buyers.

Q. Okay, and is there any reference in there about a user of a boat that might bring that boat from out of state and use it in this state?

A. There's a section entitled the Use Tax, and it talks about the customer owing a use (p. 172) tax on a boat that he or she brings into Texas.

Q. Okay, and does it require them to remit taxes on it?

A. Yes.

Q. Okay. Now, is—from your experience in the Tax Administration Division, is that an item that might be a large ticket item that might generate the types of tax dollars that you're looking to collect?

A. Yes, sir, it is plus we get—we have specific information about boats so that it's a lot easier to get the

information and the people about boats than it is the public in general.

MR. MENDEZ: Pass the witness.

RECROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. One final question. Ms. Hutcheson, on the boat example, you have to register a boat to get a license—a little sticker to put on the boat, don't you, to pay a fee to the wildlife—

A. I think, yes, Texas Parks and—

(p. 173) Q. And you can't get a sticker, unless you show your sales and use tax has been paid?

A. That's correct.

Q. And you enforce that obligation?

A. Plus we also get information from—I think it's the Coast Guard on people who are bringing boats into Texas.

Q. So that if they ever come in and register it, they have to pay that use and sales tax or show their receipt to get the certificate?

A. Well, we get the people who bring boats in, whether or not they register them, but we also get it in the situations where they're registered with the Parks and Wildlife.

Q. But you make no similar effort for magazines—made no effort to inform people who read magazines, put signs up at the library, anything?

A. We don't get any lists from any particular division or agency about people who are coming in with magazines like we do boats and aircraft.

Q. Or who live in Lockhart, Texas and take *Reader's Digest* and don't pay the tax?

A. That's correct.

(p. 174) MR. GEORGE: Pass the witness.

MR. MENDEZ: No further questions.

THE COURT: You may step down.

MR. MENDEZ: Your Honor, we'll call Mr. Mike Shoemate.

THE COURT: I'm getting a sense—I've heard quite a bit now, and I recognize you're still putting on your case, Counsel, but I haven't discovered any real disputed facts —maybe some interpretations that the Court is going to be called on to—with reference to some of these facts. Is there any way we could—

MR. MENDEZ: No, sir, Your Honor.

THE COURT: —speed this up a little bit?

MR. MENDEZ: I'd like to be able to stipulate to the fact that the Comptroller, you know, has a business reason—a cost effectiveness reason for not—for not collecting the taxes from certain people, but (p. 175) what—I don't think that's possible, and essentially what I'm trying to show is that he has a finite set of resources, and he's trying to make a reasonable effort to collect taxes in the most economical way he can, and that if you start doing the things that they're asking us to do, it becomes kind

of absurd, and I think that's been pointed out, but the case law that we've pointed out—the Alabama case that's there and, of course, *National Geographics* seem to require some sort of proof, and I'm willing to tell the Court everything that my client does to collect taxes and why they pick on one person and not on another from an economic standpoint, a business standpoint, just the same way as the plaintiffs have said they're not going to collect the tax and they'll eat it—because it's a business decision, and I think that's relevant testimony under that case law.

THE COURT: All right.

MR. MENDEZ: If we can have him sworn?

MICHAEL SHOEMATE

was called as a witness and, having been (p. 176) previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Could you please state your name and address for the record?

A. My name is Michael Shoemate. I reside at No. 1, Pettytown Road, Red Rock, Texas.

Q. Okay, sir, and how are you employed?

A. I'm employed with the State Comptroller's office.

Q. And how long have you been with the Comptroller's office?

A. Fifteen years.

Q. Okay, and could you tell the Court what your position is currently with the Comptroller's office?

A. I'm area manager for the Comptroller.

Q. Okay, and what area—in what division do you work, sir?

A. I work in Field Operations Enforcement Division.

Q. Okay, and what area of the state is your particular area?

(p. 177) A. I'm responsible for the eastern one-third of the state.

Q. Okay, and what did you do prior to being an area manager?

A. I was a field office manager in enforcement in Austin.

Q. And how long were you a manager here in Austin?

A. For eight years.

Q. Okay, and prior to that time, were you employed with the Comptroller?

A. Yes, I was an enforcement officer for seven years in Houston.

Q. Okay, and did you manage another office in Texas as a—

A. I managed for one year in the Bryan field office.

Q. Okay, sir, and what did you do before you went to work for the Comptroller's office?

A. I worked for a sales and collection organization in Houston.

Q. Okay, and do you have any college education?

A. I attended the University of Houston.

(p. 178) Q. Okay, and could you tell the Court what types of courses you might have taken there?

A. I majored in accounting and business.

Q. Okay, and did you do this in connection with your employment with the—

A. Yes.

Q. Now, have you attended—well, you're in a management position now. Have you attended any management seminars with the Comptroller's office?

A. Yes, we have provided to us inhouse management training. We also have provided—management training provided by other universities.

Q. Okay, and are you familiar with the taxes, or are you kept up to date with the technical side of the taxes?

A. Yes, our training also includes technical.

Q. Okay. Now, sir, could you explain to the Court what the Field Operations Enforcement Division does?

A. Well, it's our responsibility to ensure that the identifiable segment that's permitted for the State are currently paying and (p. 179) filing taxes.

Q. Okay, and does this also include finding persons that may not have permits at this time?

A. In some cases it does. We conduct various tasks to identify people that may be responsible to owe tax but

are not identifiable through our taxpayer list within our computer.

Q. Okay, sir, and are you given collection assignments by the other divisions of the Comptroller's office to go collect taxes?

A. Yes, sir, we are.

Q. Could you give the Court an idea of how many collection assignments you might get in a year, let's say?

A. Well, for example, the first three months of the fiscal year we generated a hundred and thirteen thousand collection assignments to the field.

Q. Okay, and do you do other types of assignments for the Comptroller's office?

A. We do investigations generated by the different tax divisions covering cigarette tax or fuel smuggling things of that nature.

Q. How many taxes do you administer in (p. 180) your enforcement group?

A. Predominantly 13.

Q. There are other taxes but they—

A. Yes, sir.

Q. —might not be that important? Now, do you provide any taxpayer information to the citizens of the State of Texas?

A. Yes, sir, we do through our field offices. Is that—

Q. Well, what kinds of things do you have available at the field offices that someone might get through—well, from the Comptroller's office?

A. Essentially we have all information that's made available to the public from the statutes to newsletters that are issued by the agency, to various pamphlets or brochures that are made available to the public.

Q. Okay, sir, and about how many persons work for your division?

A. Approximately 428.

Q. Okay, and how many offices do you have in the State of Texas?

A. We have 41 offices throughout Texas, and we have a phones collection bank here in (p. 181) Austin.

Q. Okay. Do you try to locate these offices in large metropolitan areas or what—

A. The majority of our offices are located in the metro SMSAs.

Q. Okay, and is there a specific reason for doing this?

A. Generally it's because of the volume of assignments created from those locations.

Q. Okay, and could you explain for the Court what types of programs you have in place to carry out your job —your functions?

A. Well, essentially our entire program is based on voluntary compliance, but through our computer system we identify those that don't file and pay their tax returns. We—as mentioned earlier, we conduct roadblocks to identify fuels violations, a possibility of detecting audit leads from out of state purchases. We do canvassing projects,

both physical and phone, and I'm sure there's some others that I don't—you know—

Q. Could you describe for the Court what kind of canvassing activities you conducted after the 1984 tax changes?

(p. 182) A. To the best of my memory we conducted a canvass prior to the change.

Q. What did that consist of? What industries might you have contacted during the course of that?

A. Everyone that was identified to us by our Tax Administration Division that would fall within the guidelines of the new legislation.

Q. Okay, sir, and just to put it in perspective, what were you doing at that time?

A. I was a field office manager in Austin.

MR. MENDEZ: Okay. At this point, Your Honor, I want to mark another exhibit.

(At this time an instrument was marked as Defendants' Exhibit No. 12 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. I'll have you identify this document, sir. Is that a document that you received in your office while being an Austin field manager?

A. Yes, sir, this is the style of information transmittal document to all offices.

(p. 183) Q. Okay, and could you give us the date of that document?

A. It's August 3rd, 1984.

Q. Okay, and who is it from?

A. At that time it was from Robert Storey, our director.

Q. Okay, and is this a document that you used in conducting your business?

A. Yes, this is an informational memo to tell us, you know, priorities or what we could be doing, updates on information. It's a general memo, and what it has in it—let me look through it right quick. Okay. This contains the original memo submitted from Tax Administration Division identifying the different types of business codes that were effected under the new legislation.

MR. MENDEX: Okay, sir. I'd like to offer Defendants' Exhibit No. 12.

MR. GEORGE: I'm not sure what's relevant of it.

MR. MENDEZ: I'm going to ask him some questions as to what he did with it after he got it.

MR. GEORGE: I don't have (p. 184) any objection. May I add to the Court that if the purpose of this examination is to show that the Comptroller has lots of responsibilities in the budget and needs—and has people that work hard to try to collect taxes generally, I can stipulate that. If that's the purpose—

MR. MENDEZ: That's not the purpose. The purpose is to show that we spend the appropriate amount of time with each specific and each effort that we—I mean, each type of situation that we can and that it amounts to

such a level of activity that we haven't discriminated in an unconstitutional manner against any specific group from an as applied basis.

QUESTIONS BY MR. MENDEZ:

Q. I'll hand you back this document, Mr. Shoemate, so that we can continue to discuss it. Did you conduct a canvass of your area of Austin pursuant to the information that you obtained from this document?

A. Yes, sir, we did. In fact, it was statewide, to the best of my knowledge.

Q. Okay, sir, could you identify—could you turn to the last page of that document? (p. 185) What's contained on that page?

A. Types of businesses identified by Standard Industrial Code.

Q. Could you give us the last three or four items listed in that?

A. Book stores, local newspapers, local magazines.

Q. Okay. Now, these are items that were identified to you by your superiors as being affected by the new tax changes; is that correct?

A. Yes, sir, by Tax Administration Division.

Q. Okay. Did you do anything to attempt to contact these people and let them know of their tax liability?

A. Yes, sir, we conducted a canvass of all of the identifiable segment in the city.

Q. Okay. Could you explain for the Court what you and your employees did once they got this memo and how you proceeded to inform all of the persons on that list?

A. Well, first we had to identify who, by name and association, would fall into the affected SIC codes—like a laundry. We would (p. 186) go into the phone book, identify all of the laundries in town and contact them to be sure that they were either/or permitted or non-permitted and be sure that they understood the new tax law change, provide whatever written information we had at that time.

Q. Okay, and could you describe for the Court how you divide up your part of the—of the State so that your employees can work it?

A. Well, it's regional by office. Simply stated, if I could use the situation of Austin, you have a staff of enforcement officers, and you divide up on an equal basis by zip code basis so that they're in an assigned area, and they're responsible for what takes place within that area.

Q. Okay, sir. To the best of your knowledge or from your experiences with that memo, do you know if the magazine publishers that were located in your area were contacted?

A. To the best of my knowledge, they would have been.

Q. Okay, and each field officer, each representative and his section of the State would have had to locate and inform the people (p. 187) on that list or would have had to try to locate every person?

A. Yes, sir, that was the overall objective—would be to get the information out to the public of the new change.

Q. When did you conduct your canvass?

A. During the months of August and September of 1984.

Q. Was it completed by that time?

A. I'm going to assume it was, yeah.

Q. Now, did you have to go back and recanvass later on?

A. We had a follow-up project completed, I believe, around November of '84 just to do a sample survey to see our effectiveness, to possibly detect our percentage of error of someone we might have missed. We've also—since November of '85, we redid another survey by phone into the various industries to determine the percentage of error again.

Q. Okay, sir. Now, what—do you have any other audit programs that might be in place in the enforcement Division?

A. I don't understand your question.

Q. Well, do you attempt to canvass—I (p. 188) mean, to audit or to check, you know, your tax base for compliance to make sure that everybody is filing or not filing during the course of the year?

A. Well, when you say the word audit, no, we don't audit within my division. That's another division, but we work generally just from what's identified to us from the

computer initially. Then we do some types of investigations to identify tax abuse or tax evasion.

Q. Do you maintain a phone bank in your headquarters to contact some of these individuals?

A. We have a phone bank located in Austin.

Q. Okay, and that's different than the tax assistance phone bank; is that correct?

A. Yes, sir, this is a collections phone bank only.

Q. Now, sir, could you explain some of the collection actions that you might take against a person just briefly, if they didn't pay?

A. First of all, like I mentioned (p. 189) earlier, it's identified to us. If we're using the example of a tax return if someone does not file or does not pay, then that assignment is generated depending on category either to our phone bank or to our field offices. From there, assuming that it goes to the field, the field enforcement officer makes contact with the party, obtains the necessary information, either resolves the account, or it could continue on into statute areas, such as freeze and levy or—

Q. Okay, sir, and do you divide up the accounts that you give the phone bank, as opposed to the ones you give the individuals that are out on the streets?

A. Yes, sir, we have to.

Q. Do you do that on the basis of how much they're worth?

A. Everything that goes to the phone bank is less than $400. Everything that goes to the field is over $400.

Q. Now, I want to give the Court an idea of what kind of resources you have to work with. Could you tell them how many people you have working for you?

A. Statewide or just my area?

(p. 190) Q. Statewide.

A. We have approximately 400 people in the field.

Q. Okay, and are these the only enforcement officers that the Comptroller's office has?

A. No, that includes everyone. We have about 200 and—approximately 250 enforcement officers.

Q. Okay, and are these at various levels of experience or how are these—

A. Yes, sir, they're graded in levels of one to four.

Q. Okay. Do you think that you have a well qualified staff of enforcement officers?

A. Yes, sir, we have 208 senior enforcement officers.

Q. Okay. Could you give the Court an idea of what types of people you might hire, what kinds of qualifications they'd need to be an enforcement officer?

A. Generally the posting that we issue out for employment requires or prefers a college degree, four years related experience—you know, other general items.

(p. 191) Q. Do you train those individuals?

A. Yes, sir.

Q. Okay. I guess we shouldn't get into everything that you are teaching, but I gather that they learn the statutes; is that correct?

A. Yes, sir, that's one of the first things they go through.

Q. Okay, and in order to progress and become a high level enforcement officer, do they have to exhibit any knowledge of the statutes or the various taxes?

A. Yes, sir, they do. Generally an entry level enforcement officer for approximately the first year, depending on their own capabilities, deals with sales tax only, and they can advance, so to speak, by the level of other—their competence in other taxes.

Q. Is each one of these individuals—these EOs in charge of his own area and responsible for contacting people in that area?

A. After their first six months they're assigned an area essentially independent with over—someone overseeing what their activities are, such as another senior EO.

Q. If they fail to properly communicate (p. 192) policy to taxpayers, is there a mechanism by which you can check them and make sure to correct situations like that?

A. Well, we do office observations on that person while they're in the office in answering taxability questions. We send other officers out with them to see how they're conducting their business out in their area. The managers ride with those people to see how they're doing their business, yes.

Q. Okay, sir, and if somebody were to—if they were to notice a new business go up in their part of the—in their sector and it turned out to be a publishing business, would they go in there and contact those people and find

out what kind of information they had—what kind of business they were doing?

A. Well, I believe so. I don't think it would matter what kind of new business it was. It's—in collections training you teach psychology and tactic, and it's also like an unwritten rule—your awareness of where you are working. You realize who's going out of business, who's going into business because you're there each day, and so by standard they (p. 193) would go in and, "Are you permitted for sales tax or are you not?"

Q. Okay, and if, let's say, a magazine publisher from another state went into Dallas—a certain segment of Dallas and he opened up an advertising office, is that something that an EO might locate in a phone book or some other record?

A. It's possible, yes.

Q. Is he responsible for checking all of the businesses in his sector?

A. Yes, sir.

Q. Okay. What kind of a case load does one of these enforcement officers carry at any one time?

A. Probably about 250.

Q. That's individual assignments either field or collection?

A. Individual accounts.

Q. Okay, sir, and is he under some pressure to get these things out, or how does he work, or what is his motivation for getting his work done?

A. I don't know if you'd term it pressure or not, but we measure performance (p. 194) level on their ability to complete the assignment within a given period and whether or not they can collect that assignment in total.

Q. Okay, sir. What types of information or resources do you have available in your field offices so that these EOs might be able to know what's going on in their part of the community—in their part of the state?

A. Are you referring to our publications?

Q. Yes, or just in general what does the Comptroller subscribe to or use, or what do EOs use to make themselves aware of what's going on in their part of the—

A. Well, we have all of the tax statutes available, as I mentioned earlier. We have all of the brochures. We have a microfiche indexing system that gives all court decisions, all hearings decisions on audits. I don't know the term, but it's a letter where somebody may have written into the agency, "This is my situation. Is it taxable or is it not?"

Q. So they have a—

A. Various other sources.

Q. So they have resources on how to (p. 195) interpret policy?

A. To the best of their ability. We have as a—in tax administration we have a section that if that person is unable to obtain the answer needed that they can call upon as, so to speak, the special materials experts.

Q. Okay, sir, and they might get a policy decision from there, if they're not familiar with the area themselves; is that correct?

A. They could.

Q. Okay. Now, what would an EO use to find out what kind of business is going on in his part of the community—what kind of changes are going on?

A. Personal knowledge, trade magazines, these little sale papers to see what's going on in their area, TV. You know, you see someone advertising, doing this or selling this or what have you.

Q. Okay, and well, let me ask this: In your experience as an enforcement officer or as—well, let me go on. Could you tell the Court what kind of a budget you have to operate with on a yearly basis?

(p. 196) A. Approximately 14 million.

Q. And that's each year you have 14 million dollars to use for your resources?

A. I wouldn't say each year. I just know that that's what it is this year.

Q. Okay, and do you keep track of how much money you collect on a yearly basis in terms of—

A. Yes, sir.

Q. Okay. What would that be termed? What kind of—what do you call your collections?

A. We expect to collect both current and delinquent dollars in approximately 200 million this fiscal year.

Q. And do you keep records of how many contacts you might have with the public during any year?

A. Yes, sir.

Q. Okay, and how many do you usually have during a year?

A. I don't know.

Q. Okay, sir. In the course of your employment in the management of this area, are you aware of any program or any computation that (p. 197) the agency has done with respect to how much it costs an EO to complete a transaction, you know, in terms of dividing the amount of money you collect by the volume of transactions?

A. We haven't—you mean what does it cost us to call on someone else?

Q. Yes, sir.

A. Yes, sir, we have one. It shows that like almost a year and a half ago it was $15 some-odd cents—

Q. Okay, sir.

A. —to make that contact.

Q. So it costs over $15 for each contact, each field assignment? Is that what you're—

A. No, it was based on whether it would be considering all overhead and the number of assignments—

Q. Okay, sir.

A. —whether it be by telephone or the taxpayer came into the office or we had to send an agent out, which is the most expensive, but the overall average was 15 something.

Q. So you took the total budget that you have, and then you divided by the number of (p. 198) contacts that you had in that particular year, and you arrived at a number that's in excess of $15 per transaction?

A. That may be correct. I did not work on the formula but—

Q. Do you use this figure in deciding whether or not to send people out?

A. Yes, unless it's a special request type of field investigation.

Q. Okay, sir. So if somebody in tax administration or in executive administration tells you to go check on—investigate some situation, you'll go do it?

A. Yes, sir.

Q. And that's your job; right?

A. Yes, sir.

Q. Can you give the Court an idea of what time you spend, let's say, on collection activities versus detecting new taxpayers?

A. We spend about 60 percent of our time on collections, which includes everything—investigations of all sorts. Probably about—the remainder is spent with taxpayer services where people are actually coming to our offices.

Q. Okay, sir, and during the (p. 199) depositions in this case there was an individual, Mr. Dale Craymer—do you know Mr. Dale Craymer?

A. No, sir.

Q. Okay. He's an employee of the Comptroller's office who was deposed and he—it turns out he reads a lot of magazines, and I added up the amount of the subscriptions in his magazines, and it come out to—let's say, from a hypothetical standpoint, to about $281, and I'm asking this in a hypothetical standpoint. Do you know offhand more or less how much tax that would accrue here in Austin, because he lives here in Austin, in this hypothetical from $281?

MR. GEORGE: That's an extremely leading question. I'll object to it.

THE COURT: I sustain the objection.

QUESTIONS BY MR. MENDEZ:

Q. Mr. Shoemate, if I told you that somebody owed—I mean, had purchased $281 worth—a consumer had purchased $281 worth of products and was using them in Texas, do you have an idea how much tax that would give rise to?

(p. 200) A. Not right off the top of my head.

Q. Okay. If you compute that, would it be—well, let's say that it was $300. Let's just round it off, and you're in Austin, and it's a little bit over—

A. Approximately $18.

Q. Okay. Now, if I called you up and I was—let's say I was in tax administration, and I gave you that kind of an audit lead. Would you send somebody out to go check on Dale Craymer or anybody else because they owed $18?

A. Probably not.

Q. Okay. So there would have to be some extenuating circumstance or some other reason for going out there than just to collect, you know, $18?

A. Yes, sir, when we use the $15, we have to look at—each contact that we make generates about $900. So if you're trying to say there's a trade off there, yes, sir, I'd have to make a decision whether to send that person out for 900 or 18.

Q. Okay, sir, and there's been some testimony elicited here as to the Comptroller having to collect taxes from all consumers and (p. 201) from every household or every person that purchases and uses items outside the State of Texas and brings them for use—into use in the State of Texas. What—could you explain—if I'm a household and I've incurred a use tax liability for my camping equipment that I purchased from out of state, what types of collection actions would you take against me in the normal course of your business?

A. Oh, we would attempt to contact you. If you're the normal household, you're not at home during the day. So our next step would be to estimate a tax return on you. You would get a notice of demand for payment. If you failed to pay it, we would go to the extent possibly to freeze or levy your bank account. I mean, it depends on the individual circumstances but—

Q. How could I prove to you that I—you know, that the company I purchased it from had remitted the tax for me?

A. You could produce the sales ticket.

Q. Okay, and if I'd lost that, would you take my word for it?

A. Well, I assume we could probably verify it through the seller.

(p. 202) Q. Assuming I wouldn't provide you—I filed a return and didn't send you any money, would that be a return that you would send a field assignment out on?

A. Repeat that.

Q. If I filed a return with the Comptroller's office and I put zero tax or I put down I purchased a hundred dollars' worth of goods from out of state and I'm not remitting any tax, would that generate a collection action?

A. Yes, sir, but not to the field.

Q. Okay. Well, it's been your testimony, sir, that you file liens and you freeze bank accounts of people that have permits now. Now, would it be—would you use these—would you have to use these same tactics against households in the State of Texas in order to be fair in what you are doing?

A. Possibly if there was no other way to resolve the situation.

Q. Now, sir, have you become aware of, through your job as an area manager or through your job as an office manager in Austin—of any plan by the Comptroller to leave out any out of state publishers that might have nexus in the (p. 203) State of Texas—to just not deal with them?

A. I'm not aware of any.

Q. Okay, sir, and if somebody had said, "Don't enforce the sales or use tax against a particular individual,"

would that have come to the knowledge of the Enforcement Division?

A. I would assume it would, if we were specifically told not to do something.

Q. Would you—the employees that you have—are they instructed to collect and to permit anyone that has use or—sales or use tax liabilities that they come in contact with?

A. If we're able to identify that they have made purchases. I mean, we do several things that does identify to us, such as—an example, Parks and Wildlife submits us a list of boat registrations from out of state, and we contact the owners and set the use tax up on that, yes.

Q. Okay, sir, and if somebody comes up to you and says, "I just brought in some clothes from New York and I didn't pay a sales"—or "I just had some clothes shipped from New York to me here, and I didn't pay a New York sales tax," would you take their money, if they gave it to (p. 204) you?

A. If they walked in the office, we'd take their money.

MR. MENDEZ: Pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Could I see that exhibit you have in your hand there, Mr. Shoemate? By the way, are you related to this lady who's been with us through our trial, Mona Shoemate?

A. Yes, sir.

Q. Congratulations. Now, I believe you made a reference to a canvass that you're—somebody was supposed to do under your supervision of various organizations after the passage of the taxes in the summer of '84?

A. Yes, sir.

Q. Okay. You went—did somebody go to all of the kind of businesses on this list including amusement parks, antique shows, drag strips, golf courses, pool halls, hot tubs, concessions?

A. Well, some of the industries—and (p. 205) I'm not familiar with exact which ones—were notified through their associations.

Q. Which ones do you know from your own personal knowledge that canvassers went to? Can you swear that somebody went to anywhere?

A. Sure.

Q. Who?

A. We went to all of the above on that list that we could identify.

Q. Did you—people—did somebody—you said that somebody went to see the local magazines, to the best of your knowledge?

A. To the best of my knowledge.

Q. Do you know—

A. Me, personally, did not go.

Q. Did you go with anybody?

A. Not during that time.

Q. All right. Did anybody send you a report that they went?

A. They keep daily activity records of where they went.

Q. Can you tell the Court of seeing any daily activity report of anybody who went to see a local magazine?

A. At this time, no, sir, I cannot.

(p. 206) Q. You don't remember any of them, do you?

A. Well, I've—you know—

Q. Okay. Let me ask you do you take any magazines?

A. One.

Q. What's that?

A. *The Horseman.*

Q. *The American Horseman?*

A. No, sir, just *The Horseman.*

Q. *The Horseman?* Is that published in state?

A. Yes, sir, it is.

Q. Do you know whether its taxes are paid?

A. To the best of my knowledge, it is.

Q. Do you pay any on your bill?

A. I don't know. I haven't checked the bill.

Q. Okay. You don't know? Let me ask you do you ever have people call on you to sell you magazine subscriptions?

A. No, sir.

Q. Do you have any kids?

A. No, sir.

(p. 207) Q. Do you know whether or not there is a practice of people having solicitors in the state going door to door and soliciting magazine orders?

A. Yes, sir.

Q. There are?

A. Well—

Q. Do you know whether those solicitors are soliciting magazine orders for out of state publishers?

A. I'm not aware whether in all cases it is for out of state publishers or—

Q. Do you know—

A. —in state.

Q. Excuse me.

A. Pardon me?

Q. I didn't mean to interrupt you. Have you finished?

A. Yes, sir.

Q. Okay. Do they solicit from—do you know that they do solicit for some out of state publishers?

A. I don't know that for a fact, no, sir.

Q. You believe that to be the case?

(p. 208) A. Well, when I lived in the city most often if someone came to your door, they were representing The University or a local PTA or—

Q. They had a whole list of magazines, though?

A. Well, they may have. I never subscribed to one. I never asked.

Q. But they called on you?

A. Yeah, they knocked on my door.

Q. Yes, sir, and they were—you were familiar with the sales tax statutes, aren't you?

A. Somewhat, yes, sir.

Q. Yes, sir, and you know that if someone—a publisher of *Reader's Digest,* for example, or *Sports Afield* or any other publication has people in this state taking orders for it, it's doing business in this state, don't you?

A. Yes, sir.

Q. And you knew that when you were in the Enforcement Division living in the city?

A. Yes, sir, but—

Q. And people called on you?

A. Yes, sir, that's true.

Q. And you didn't do anything to check (p. 209) to see whether those people were paying taxes, and you haven't done anything to check to see if they were paying taxes to this day, have you?

A. Well, if it was an organization sponsored through The University or through one of the local schools, we

already know from experience or we can go and check the computer that the local PTA is permitted.

Q. Mr. Shoemate, I asked you did you go and check to see whether the publisher who had representatives taking orders in this state and thus doing business in this state was paying taxes on subscriptions sold in this state?

A. No, sir, we always checked back to see who the organization was selling.

Q. I understand. So you haven't done one thing to collect—to take any effort to enforce the tax against any out of state publisher, have you?

A. To answer your specific question, no.

Q. And in the—what—15 years—well, it's been on the books since October 1984. Nothing has been done, has it, to your knowledge, in the eastern third of the State where you've been working?

(p. 210) A. Not to my knowledge.

Q. In all of these years ever since that period of time, October 2nd, 1984?

A. To my personal knowledge, I don't know.

Q. You don't know of anything?

A. No, sir.

Q. All right, but you were directed to call on local magazines?

A. That was the requirement in the canvassing project, yes, sir.

Q. Now, was there any—has the requirement to canvass ever been rescinded?

A. No, sir, we have an ongoing process where we contact 25 percent of the tax base each year.

Q. Has anybody in your office ever been told not to canvass--not to go to any particular kind of organizations?

A. Not that I'm aware of.

Q. All right. Now, in connection with the consumers that owe taxes, tell the Court about any action you've ever taken against any consumer to collect taxes—enforce taxes against a non-permitted, non-use tax permitted, (p. 211) non-business consumer?

A. Well, the example I used on the boat purchases.

Q. The boat purchases? Anything else?

A. We do it on plane purchases.

Q. Airplane purchases? How about any magazine purchases?

A. Not that I'm aware of on specifically magazine purchases.

Q. How about people buying clothing, in fact, if that's the case?

A. Well, generally that is the—the hardest to identify, if anyone buys anything and brings it in out of state, unless we have a traceable record, such as the boat or airplane industry.

Q. Do you have any—do you make any effort to identify people who have solicitors in the state?

A. Yes, I mean, we are aware of where—I don't know the company's name, but they'll bring in people from out of state to sell paintings door to door and—

Q. What about people who—

A. —we try to—try to identify who (p. 212) they are when we see them operating within the state, yes.

Q. Have you ever had anybody do anything on magazines that have advertising sales offices in the state?

A. Not that I'm aware of.

Q. You mention that you might—that's possible that somebody could do that—that one of your enforcement persons could look in the Dallas phone book and see—or in the Houston phone book and see if *Time, Newsweek* or some other company had an office in that city and take enforcement actions?

A. Sure.

Q. Haven't ever done it, have you?

A. I can't say that they have or have not, if they could identify in the phone book.

Q. You can only tell the Court, Mr. Shoemate, what you know, and I ask you do you know if they have done it?

A. Me, personally, I don't know if they have or have not done it.

Q. You can't say that they have?

A. I can't say that they have not.

Q. How long have you known about this (p. 213) lawsuit?

A. Probably a couple of months or whatever. I don't really know how long.

Q. During that period of time have you simply picked up the phone back [sic] and looked in Dallas and Houston and seen if they have any sales offices and done anything about it?

A. No, sir, I have not looked in the phone book.

Q. And that's your responsibility to enforce this statute?

A. Yes, sir, it is.

Q. And is Dallas or Houston in the eastern third?

A. Houston is, yes, sir.

Q. But you haven't done it?

A. No, sir, not since I've been in that position.

Q. That's been the last two or three months?

A. Just five months.

Q. Yes, sir, and during that period you have known about this lawsuit, and despite knowing about the lawsuit, you haven't done it, have you? Your wife has been involved in the (p. 214) lawsuit, at least to some extent?

A. Well, that's how I know about it.

Q. And despite that, you haven't done anything to do anything to try to enforce against out of state publishers?

A. Well, as I stated earlier, we try to do things that are cost effective for us, and we've identified three areas in the last five months that generated millions of dollars in revenue for the State—

Q. Mr. Shoemate—

A. —and you know, the year is not over yet. So—

Q. —you understand that—have you gotten any information about how many out of the state magazine sales are ordered in this state?

A. I'm not aware of how many there are.

Q. If they're—according—do you know Phyllis Coombes?

A. No, sir.

Q. Do you know if they're—if it was told or information was in the hands of the Comptroller that there were 290 million dollars' worth of sales of magazine subscriptions each year, would that be a significant sum of money (p. 215) to try to tax in Texas?

A. I would assume so.

Q. And nothing has been done; is that right?

A. Not at this time.

Q. Do you think you may get around to it?

A. Well, you know, it depends on how we plan the remainder of the year and what projects we go after.

Q. But you don't know about it yet?

A. Well, from the standpoint of when the tax became available, you know, we try to plan what we have case history on, so to speak.

Q. Do you know Glen Castlebury?

A. Yes, sir.

Q. Is he in a position to know the policy of the Comptroller's office regarding their intentions about collecting taxes?

A. Yes, sir, I would—or a general idea of our plans.

Q. Well, is he in a position to know the policy by senior management Comptroller better than you are?

A. Yes, sir.

(p. 216) MR. GEORGE: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Well, Mr. Shoemate, at the risk of offending the plaintiffs, you mentioned that you'd been working on some specific projects that generate certain amounts of money. Does the upper level management tell you, "We want you to concentrate on a specific area or get a certain amount of money in"?

A. No, this is areas—we reorganized and we—a new director of field operations enforcement, and from there we decided these are projects that have been left undone that emit high volume tax and so we—in the first five months, we've gone after those projects.

Q. Well, sir, is it your objective to try to get the most money you can in the shortest amount of time that you can?

A. Sure.

Q. Now, sir, if somebody told you that there might be a magazine in Houston that has an office in Houston

and you hadn't received a (p. 217) field assignment from —from some other division that required you to go over there and chase after that person, do you have any time, or do you have the resources to allocate to go chase after somebody like that without knowing anything else about it?

A. Under the normal, no, because what time we have that we're not working on what we classify as a non-filer, we're usually doing other types of investigations in other taxes.

Q. Okay, sir, and how many people do you think you have working up in Houston?

A. About 87.

Q. Okay, and how many—what kind of case load on an average basis do those people carry?

A. Around 200 to 250.

Q. Okay, sir, and so are those generated by your other programs?

A. Yes, sir.

Q. Okay, sir, what would happen to your system is everytime somebody called up on the phone to your office and said, "There's somebody up in Houston that you've got to go check out" or "There's somebody over in El Paso that you (p. 218) have to go check out" without giving you any other information—what would happend to your system of organization if you went around carrying each one of those out on a daily basis?

A. Probably total disruption of the function.

Q. Okay, sir. How much money do you collect on each contact that you make with a taxpayer?

A. Approximately $900.

Q. And this is a system that you've had in place for how long—this system of enforcement? How long has the Enforcement Division existed?

A. Its total existence I don't know. The non-filer program identification by the computer has been ongoing since 1970, from the best of my knowledge.

Q. Okay, sir, and there was a question asked of you earlier about identifying whether or not some child that came to your door was permitted or not or whether he was soliciting for some out of state company. Do you check out your records to make sure that at least that group—that child is represented—has a (p. 219) permit?

A. Yeah.

MR. MENDEZ: No further questions.

THE COURT: Did you say yes?

THE WITNESS: Yes, sir.

RECROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. When is the last one you checked?

A. Well, I haven't had anybody call on me personally like that in almost five years.

Q. Before that did you ever—you, personally, ever check anybody?

A. Yes, sir, me, personally, I did. I mean, do you want an explanation, or do you want a yes or no?

Q. Did you—I just want to know if you checked anybody?

A. Sure. We used—I mean, just like the example I gave just because the nature of the job of being in enforcement—

Q. You went and checked the PTA one time to see if they had a sales tax permit?

(p. 220) A. Well, rather than harass the child, yes, we would go back and see if the PTA or the Boy Scout group itself was permitted for the collection and remittance of tax, and if they were and had been filing tax returns, then—

Q. You made no further investigation?

A. —you really make no further investigation. Those type organizations are set in what they do and how they —in most cases the school district will hold the ultimate permit for all of their operations. We also have other accounts we're verifying for nontax. So—

Q. I'm just trying to find out since October 2nd, 1984 have you checked out—can you swear here today that there has been a PTA checked out who's selling magazine suscriptions from out of state?

A. I cannot swear to that, no.

MR. GEORGE: Pass the witness.

FURTHER REDIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Mr. Shoemate, when you were doing (p. 221) this job out in the field, those types of examinations, those

types of verifications of PTA groups and others was expected of you; is that correct?

A. Yes, sir.

Q. Now, sir, you're a manager, and you're over all of the people in East Texas. Do you expect for them to carry out their job the same way that you used to do it?

A. Yes, sir.

Q. Okay, and from your understanding of how those people are trained and how you manage them, would you think that—would it be reasonable for us to assume that they contact the same type of people that you used to contact?

A. Yes, sir.

MR. MENDEZ: Pass the witness.

FURTHER RECROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Let me ask you one question. You were doing field work before 1977?

A. Yes, sir.

Q. And do you know whether or not (p. 222) magazine subscription sales were at least on the books subject to tax then?

A. Yes, sir, I believe they were.

Q. They were? And did you ever go out to an out of state—see somebody taking orders for out of state sales—for an out of state publisher and go and try to

find that out of state publisher and collect the taxes on that sale and all other sales that publisher had?

A. I personally can't recall as far back as 1977 whether I did, but I don't recall one, no.

Q. And the fact of the matter is that never happened in your experience, has it, during the period before '77 and after October 1984?

A. Where I personally have contacted a publisher?

Q. Yes, sir.

A. No, sir, I can't recall.

MR. GEORGE: Pass the witness.

MR. MENDEZ: No further questions.

THE COURT: Step down. (p. 223) We'll take a 20-minute recess.

(At this time a brief recess was taken, after which time the proceedings continued as follows:)

MR. MENDEZ: Your Honor, we call Wade Anderson.

WADE ANDERSON

was called as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Would you state your name and address for the record, sir?

A. My name is Wade Anderson. My home address is 3505 Scenic Hills Drive, and my office address is 113 East 17th Street.

Q. Okay, sir, and by whom are you employed?

A. I'm employed by the Comptroller of Public Accounts.

Q. And what is your position with that office?

A. I'm general counsel.

(p. 224) Q. Okay, sir, and what are your duties as general counsel for the Comptroller's office?

A. Well, as general counsel I oversee many policy decisions that are made within our office. If legal questions arise, I'm usually involved both at a divisional level, and I will also be consulted by lawyers on the staff about general questions, as well as the administration. I deal with interstate taxation committees and associations and serve as Mr. Bullock's alternate representative on a few of those and just what legal problems come up I find myself addressing.

Q. Okay, sir, in your position as general counsel, have you become aware of any plan or scheme on the part of Comptroller or his staff to target a selected person or persons for selective enforcement of the sales and use tax?

A. Certainly not.

Q. Okay, sir, and have you had occasion to review any policy statement or rule or other document which specifically targets *Texas Monthly* or any other Texas publisher of magazines for enforcement of the sales and use tax while specifically excluding all of those (p. 225) out of state companies?

A. No.

Q. In your role as general counsel, have you had occasion to consider the tax treatment of companies that sell magazines or other types of tangible personal property to citizens of Texas but that may not have employees or a place of business here in the State of Texas?

A. Yes, I have.

Q. Okay, sir, and what's the Comptroller's position with respect to those types of companies that do not have contacts with the State of Texas?

A. Well, our basic position is that if there are no contacts that we do not have a right to tax them—that there's not constitutional nexus.

Q. Okay, sir, and could you give the Court an example of somebody that you clearly do not think has nexus with the State of Texas?

A. All right. Well, for instance, if you had a company that was advertising in national media—maybe 1-800 toll lines made sales to Texas citizens by means of this (p. 226) advertising and delivered their products, say, through the U.S. mail, we would say that did not—that company did not have nexus, and we would not be able to tax them.

Q. Okay, sir, and have you become familiar, in your position as general counsel, with the types of problems and situations that occur with the different levels of contact of companies with the various states?

A. Well, not all of them, of course, but many of them.

Q. Okay, and are those problems that are considered by the Comptroller of Public Accounts of the State of Texas in addressing these types of issues?

A. Well, when you start talking about, you know, taxation of these companies that have very limited nexus or no nexus, you know, the problems that surround those are discussed with other State tax administrators, and I —you know, we are aware of them, and I have—I have personally talked to a number of tax administrators about them. Maybe I haven't answered your question there.

Q. Well, that's sort of the area I was (p. 227) getting into. What steps has the Comptroller of Public Accounts taken to address the out of state sellers issue?

A. Well, we've really addressed it in two different ways. The most direct way is through our cooperation with the MTC in using them to address these mail-order type businesses, nexus being a very delicate and, you now [sic], close question in many instances. They are very well qualified to deal with that. The second area is that we have tried to encourage the Congress of the United States to pass legislation which would clearly allow us to tax these types or require—actually to require the sellers to collect the use tax for us.

Q. Okay, sir, and in the course of your business or in the course of the Comptroller's business, has he had occasion to conduct a study to determine the amount of revenues that might be—the potential revenues that might be out there from these mail-order type interstate sales?

A. Yes, last summer I requested that such a study be performed by our research section.

(p. 228) Q. Okay, sir, and did you get that study back?

A. Yes, in September I received a cover memo from Brian Graham, who is in the research section, with a large report attached to it that went into possible losses that were occurring because we were unable to tax mail-order sales and went into the various formulas that they arrived at how—you know, at these figures.

MR. MENDEZ: Okay, sir. May I approach the bench, Your Honor? I'll have this marked as Defendants' Exhibit 13.

(At this time an instrument was marked as Defendants' Exhibit No. 13 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. Mr. Anderson, I'm going to hand you what's been marked as Defendants' Exhibit No. 13. Is that the study that you requested and that was provided to you, sir?

A. Yes, it is.

Q. And you say Mr. Graham's division is the one that handled that and—

A. Well, Mr. Graham, I believe, works directly under John Moore, but Brian Graham has (p. 229) been dealing with mail-order sales, as well as Phyllis Coombes.

Q. And does the Comptroller use these figures in his business and in determining whether to approach Congress to decide—to urge legislation to address the problems that are involved?

A. Yes, he has.

MR. MENDEZ: Okay. At this point we'd offer Defendants' Exhibit No. 13.

MR. GEORGE: I have no objection.

THE COURT: Admitted.

MR. MENDEZ: And I'm not going to be using this, if Your Honor wants to—

QUESTIONS BY MR. MENDEZ:

Q. Now, Mr. Anderson, can you tell the Court more or less how much money the Comptroller feels is at issue in the out of state sales without nexus situation?

A. Well, essentially the report looks at a maximum available, and they estimate it's between a hundred and a hundred and forty-five million dollars a year is probably being missed because we cannot require these out of state (p. 230) mail-order companies to collect the use tax for us. Any legislation, of course, that passed that would allow us to do that might have limits as to how large a company had to be before they would be required to collect the money either nationally—you might have a company that, say, had 12 million dollars in sales a year nationally before they would be required to collect the use tax, and they might have to have, you know, a hundred thousand or half a million dollars—whatever the cut off might finally be decided upon. If a very high cut off was used, that figure, a hundred and thirty million, of course, would drop, and it's just a function of the numbers.

Q. Okay, sir, and obviously there's a statute in place now that allows the Comptroller to collect a tax from users —the end consumers in this state, and why has the Comp-

troller decided to address the Congress of the United States on this issue, as opposed to trying to collect it from the consumers?

A. Well, when we perform audits we regularly pick up use tax from the sales tax permit holders who we do audit, if they have not (p. 231) paid it. Under the law a permit holder is supposed to report a use tax, but very often it is not reported. The problem with mail-order sales is that many of those sales are made to individual households and people who do not hold permits who would never be audited and are made in such large—such small dollar volumes that it would be uneconomical to audit them.

Q. Okay, sir, and so the Comptroller has made a decision not to collect a tax at that level but to address the Congress and to try to collect it from the sellers; is that correct?

A. Well, I'm not sure I can say he's made a decision never to collect it against a consumer, but he has certainly made the decision that it is in the economic best interests of the State to be able to require the seller to collect it.

Q. Okay, sir, and could you tell us what the status is of legislation before the Congress of the United States on this issue?

A. Well, a little brief history—last June—

MR. GEORGE: Your Honor, this is all really interesting, but what the (p. 232) status of some bill in Congress has to do with whether or not they try to collect the tax from people soliciting magazine sales in Texas is beyond me, and I think it's irrelevant, and I don't want to extend this simply—

THE COURT: What is the purpose? What's the justification?

MR. MENDEZ: Your Honor, Mr. George and *Texas Monthly* have been trying to ask the Comptroller's office why they haven't—if they have an action planned in the near future to collect a tax from these individuals—from individuals—

THE COURT: Is this to develop that they're looking to Congress for relief?

MR. MENDEZ: Yes, and I want to show that there are bills in Congress that are going to pass soon or might pass soon. There's a possibility of passing and that that's one reason why they may have forced all in one area—because they're looking to a better way of doing it.

THE COURT: And the excuse that the Comptroller is going to be offering is (p. 233) that we're looking to Congress for relief?

MR. MENDEZ: There's a better way of doing it.

THE COURT: I know but still basically that you're looking to Congress for the relief?

MR. MENDEZ: Yes, sir.

THE COURT: I'll sustain the objection.

MR. MENDEZ: We'll offer it in under a bill of exception, Your Honor, and I'll have the bill start at this point.

QUESTIONS BY MR. MENDEZ:

Q. Could you answer that question, Mr. Anderson?

A. I'm sorry. What the status of the present bills before the Congress are?

Q. Yes.

A. In June of this last year the NATA adopted a resolution to the effect that they would put forward legislation which would allow the states to collect use tax—require sellers to collect use tax in this situation. The State of Texas—I was on the resolutions committee at that time, and the State of Texas supported (p. 234) that resolution. Since then the bill has—that was proposed by the NATA has not been introduced, but two other bills have, which would allow this. One was by Byron Dorgan from the State of North Dakota, and his bill would allow the states to require mail-order companies to collect use tax on their behalfs [sic] without limitations. That bill is presently before the judiciary committee, and no hearing has been held in that instance. The second bill that has been introduced is by Senator Andrews, and that bill is presently before one of the subcommittees of the finance committee in the Senate, and a hearing has been held on that, and we sent a letter expressing our support for that bill. It, too, lacks limits, but there will be additional hearings on that bill. I would anticipate that sometime within the next month or so that the National Association of Tax Administrators bill will be introduced by a representative or Senator, but I don't know when that will occur.

MR. MENDEZ: That ends our bill, Your Honor.

QUESTIONS BY MR. MENDEZ:

(p. 235) Q. Now, I'll continue with the questioning. Mr. Anderson.

THE COURT: Is that all you're offering?

MR. MENDEZ: That's the bill of exceptions.

THE COURT: All right. I'll overrule the objection. I don't see that there's any—

MR. MENDEZ: So we'll eliminate the bill, in other words?

THE COURT: Right.

QUESTIONS BY MR. MENDEZ:

Q. Could you explain for the Court the State of Texas' affiliation with the Multi-State Tax Compact?

A. Yes. The State is a member of the Multi-State Tax Compact and has been since it was formed in 1967. We're just a regular dues paying member. We do participate in their audit program.

Q. What is the purpose behind the existence of the compact?

A. Well, essentially the compact is designed to bring more uniformity into the (p. 236) taxation of businesses throughout the United States. It was really formed as a direct response to the Willis Committee Report by the Congress—in Congress back in the mid-'60's, which called for multi-state legislation to tell states how to tax interstate businesses.

Q. Okay, sir, and has—you say you participate in their—in the MTC's audit program?

A. Yes, we do.

Q. Do you—have you always participated in that program?

A. With the exception of just a very few months, yes.

Q. Okay, sir, and could you explain for the Court how you got back into their audit program?

A. Well, I might first of all say that we had been in the audit program a number of years, and about a year and a half or so ago it was our conclusion that the State was not gaining enough from the audit program, and Harold Lee, who is with our office, and I both recommended to Mr. Bullock that we pull out of the audit program because of that. Thereafter, (p. 237) the formatting of the audit program was redone by MTC. I think we were not the only ones that were dissatisfied, and the emphasis was dramatically changed. I attended an executive meeting of the compact. I believe it was last—in mid-winter and expressed, you know, our concern with their auditing program and, you know, explained why we had gotten out, and at that time they indicated that they would move toward more sales tax auditing and concentrating on these mail-order type businesses, and it was for that reason that we really got back into their auditing program, and we paid, as I understand it, a special assessment strictly for that portion of their auditing program evolving around mail-order sales.

Q. Okay, sir, and do you think that this audit program that you've contracted for would spot and—or would detect and then get into your jurisdiction or at least put before it—the courts again the issue of who has nexus and who doesn't have nexus?

A. Oh, I would certainly hope so. You know, that's the purpose of it.

Q. And do you think that's a better way (p. 238) of collecting taxes than going after the end consumer?

A. Yes.

Q. And so if *Reader's Digest* is subject—or were to become subject to an MTC audit and was assessed a sales or use tax for the State—for its circulation into the State of Texas and, let's say, the MTC did something like that, would the Comptroller issue an assessment after they had done their audit?

A. We would stand behind that finding, yes, and they would have all of the full rights. You know, they would have rights to a redetermination hearing and the full set of rights that would be granted to anyone else when an assessment was issued.

Q. Okay, sir, and without mentioning any names, has the MTC in the past generated funds from these nexus type cases?

A. Yes, they have.

Q. Okay, and is that one of the considerations or one of the reasons you went back into the program?

A. Very substantial amounts of money have been received because of this. Now, they (p. 239) have not gone to court. They have—you know, essentially, MTC has gone in to do audits, and even where nexus was very, very questionable, the companies have agreed to pay back taxes, as well as to start collecting a use tax in the future on our behalf.

Q. So to the extent—well, what kinds of specialized resources does the MTC have that you're counting on to use in this—in your search for out of state companies that have nexus but are just hard to detect?

A. Well, first of all, they have an overriding interest in it. It is not just a segment of an auditing program. The mail-order business has become one of the driving points of interest for the MTC, which is always good, but aside from that, they also have very competent auditors, which our staff has evaluated and found were very competent and that they not only know our laws, but they know a number of State laws, and they are versed in nexus problems, and they also have three full-time attorneys with very high qualifications in the area that deal day in and day out with the problem, which we just generally do not do. So they're very—(p. 240) you know, they're very qualified in the area.

Q. Now, sir, turning back to the legislation portion of this testimony—

MR. MENDEZ: I want to first have these exhibits marked as Defendants' 14, 15 and 16.

(At this time instruments were marked as Defendants' Exhibits Nos. 14 through 16 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. I'm going to hand you, sir, some documents which you provided to me earlier. Can you identify Defendants' Exhibt No. 14?

A. Yes, this is the September issue of our fiscal notes containing an article on mail-order sales.

Q. Okay, sir, and is that a document that you've used in your work with the—with this interstate sales business legislation?

A. Well, I've kept it in my file. I don't know that I've actually worked with it. It's something I've received.

Q. To the best of your knowledge, is this information that was gleaned—or the information here is a policy of the Comptroller (p. 241) or the position of the Comptroller, with respect to the issue of states missing out on mail-order sales tax?

A. Yes, it is.

Q. And that's a position that you put forth to the NATA and to others; is that correct?

A. Yes, it is.

Q. Okay, sir, what issue is this again? When was it published?

A. September of '85.

MR. MENDEZ: Okay, sir. I'll offer Defendants' No. 14.

MR. GEORGE: Let me take the witness on voir dire briefly.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Is Exhibit 14 in some kind of newspaper?

A. It is a—just a brochure that we print and we mail to a number of subscribers. It's—they—it is not a charge for—

Q. You don't charge—

A. We don't charge—we don't charge for this one. You, too, can get on the list to (p. 242) receive Fiscal Notes.

Q. And the purpose of this is to explain the information contained in that other exhibit—what the numbers were?

A. I don't know if that's the purpose. I think this particular issue simply talked about mail-order sales in general and how the lack of our ability to require collection was costing the State money. The publication itself is put out regularly and addresses all sorts of issues of general concern—oil prices and a section in the back, which I never read or really understand, the Monthly Statement of Cash Condition, but it has some meaning for accountants and—

Q. Is there anything—

A. —around the state.

Q. Excuse me. Is there anything, Mr. Anderson, in this Exhibit 14—is that the number—

A. Yes, sir.

Q. —that has anything to do with magazines?

A. Not specifically as I recall. I don't recall that it's directly—

(p. 243) MR. GEORGE: I object on the grounds it's not relevant to any issue in this case.

THE COURT: Let's see it. What's—

MR. MENDEZ: He has an objection.

THE COURT: I know—on relevance. What is the relevance?

MR. MENDEZ: Your Honor, I'm trying to establish what the Comptroller is—that the Comptroller is attempting to equally enforce the tax against all—or collect all of the tax that is due, and this is an effort that he is making to attempt to carry out that objective and to the extent that Mr. Bullock has been lobbying Congress and has been—

THE COURT: You're getting a lot of extraneous in here. I'm going to overrule it, but I'm going to—

MR. MENDEZ: Well, we'll try to limit it.

THE COURT: That's your only objection is the relevancy?

MR. GEORGE: That's the (p. 244) only objection.

DIRECT EXAMINATION (Resumed)

QUESTIONS BY MR. MENDEZ:

Q. Could you identify Defendants' Exhibit No. 15?

A. This is a copy of a newspaper article—a letter to the editor that appeared in *The New York Times.*

Q. Who wrote that?

A. Mr. Bullock is the name that is signed to the bottom of the article.

Q. Okay. Is this also information that you have with respect to the efforts of the Comptroller to get legislation passed on this sales—

A. This also is just in my files.

Q. Yes, sir, and how about Exhibit No. 16—Defendants' Exhibit No. 16?—Can you identify that document?

A. This is a letter that was sent to a Craig Hines. The letter, which is signed by Tony Proffitt, attaches another letter, as I recall—let's see—attaches a letter to Jack Brooks. I wrote the letter—the rough draft (p. 245) letter for Mr. Bullock's approval to Congressman Brooks, in which he asked that the legislation be supported because we're taking a loss in our mail-order sales area. This was sent to Craig Hines for his information and use, I presume.

Q. And on the last page of that exhibit, is there a list of other persons that received that letter?

A. Yes, there is.

Q. What types of companies are those?

A. They are all newspaper companies, with the exception of the Associated Press, which I guess would be a news gathering company.

Q. And what—generally what is that? Well, is that another document—well, you prepared the actual letter that's enclosed—

A. Well, I had nothing to do with the letter that was sent out by Mr. Proffitt. The attachment to that letter to Congressman Brooks I did do the rough draft on.

MR. MENDEZ: I'll offer Defendants' 15 and 16.

MR. GEORGE: Your Honor, Mr. Bullock's letters to *The New York Times* and his letters to Congressman Brooks and to newsmen (p. 246) are again not relevant to this lawsuit.

MR. MENDEZ: We urge the same argument, Your Honor—that they explain his position in attempting to collect the tax in the most reasonable manner that's possible and from the sources that it really can be collected at.

THE COURT: Well, where is it directed to publications? I guess that's really what his objection has been all along. Where is it to—with reference to publications?

MR. MENDEZ: It was sent to the editors of several major—the publishers of several major newspapers in the State of Texas, and you know, it's showing them that there's an effort going on in the federal—and a lobbying effort to the legislators—the Congressmen from Texas to try to get that law passed.

THE COURT: Well, what I've heard—if it's a necessary fact, we'll stipulate to it, but I just don't see—we keep cluttering up the record here with things. It seems to me we're building a record on—

MR. MENDEZ: Your Honor, (p. 247) I'm trying to build the record to show—I'm trying to show from the constitutional cases that I've read—and I'm not, you know, saying that I'm the greatest constitutional lawyer or anything, but every one of those cases that talks about discrimination on an as supplied basis by a State official—everytime you have a legitimate defense of that you've got to show that you have a rational basis for treating that group of people differently, and what I'm trying to

show is there's no way for us to collect it from the consumer. There's an equal statutory liability on the retailer, and we're trying to get the legislation to get over there and overcome any burdens at the federal level that might exist under the federal constitution.

THE COURT: All right. I'll overrule the objection.

QUESTIONS BY MR. MENDEZ:

Q. Thank you. Turning now, sir, to the area of exemptions of religious periodicals, have you ever had occasion to consider any policy of the Comptroller or are you aware of any policy of the Comptroller to look to the content of any publication to what's written in (p. 248) a magazine or other document to decide whether or not to apply tax?

A. I have not.

Q. Now, we might have—we've shown the Court, I guess, today that there are efforts going on with the MTC and the Federal Congress. Have you stopped any audits that might be in progress, or have you stopped the enforcement people or sent them notices in the Enforcement Division that they not do any work with regard to trying to locate anybody that's liable for taxes?

A. No, I would expect that they would, you know, continue to do so.

Q. And if the testimony were or if the Audit Division went out and had a system in place by which they identified persons that might be doing business in Texas

and that system is working today right now, is there any reason why you'd stop them or is there any order—

A. I would encourage them. I assume Mr. Bullock would encourage them, as well.

Q. And so all of these efforts that we're talking about today are supplements, aren't they, or what are they in comparison to (p. 249) what your normal audit programs and enforcement programs are?

A. Well, of course, I'm not in audits, but my understanding is that we have an ongoing problem—problem and program with trying to identify people who are actually doing business in this state, and I have been contacted on a number of occasions as to whether sufficient nexus exists with various companies. You know, whether—well, merely delivery into Texas is sufficient nexus or if they have an office here—whatever, but those are ongoing enforcement and audit type problems, and I only see them when somebody brings a question to me. Now, they are brought to me, and on the other occasions I will be asked —information will be sent to me concerning people doing business in the state, and when that happens, I turn around and send it to either the Tax Administration Division or to our Enforcement Division to find out whether or not they're doing business.

Q. Now, it might not have been clear, without mentioning any names, but did the situation where an audit of the MTC might have resulted in funds delivered to the State of (p. 250) Texas—was that the audit of a publishing company or—

A. There was—one of the parties involved was a publishing company, yes, sir.

Q. Okay, and would that—well, is that one of the reasons why you decided to go into that special audit program that they have?

A. It was one of them.

MR. MENDEZ: Pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Let's try to be brief here, Mr. Anderson. First of all, religious periodicals. You're familiar with the statute, are you not?

A. I am, but it's been a long time since I've really looked at it.

Q. And you're—I assume the Comptroller follows the statutory language when it applies to exemptions?

A. I would hope we do.

MR. GEORGE: All right, and may I approach the witness?

QUESTIONS BY MR. GEORGE:

(p. 251) Q. The language of that statute says, "Periodicals that are published or distributed by a religious faith that consist wholly of writings promulgating the teachings of the faith are exempted from the taxes imposed by this chapter," and that requires an analysis of whether the teachings or whether the writings in that periodical are teachings of the faith, don't they?

A. The only—I only remember one instance where I have ever had occasion to look at that particular pro-

vision, and that was about, oh, 12 or 15 years ago involving a religious bookstore, and we did not, in fact, look at the content.

Q. You just ignored the statutory language?

A. I'm merely telling you what happened at that time. I do not know what happens now, but I've never seen anyone really analyze religious periodicals.

Q. Okay. Next issue. You talked about nexus being a difficult problem?

A. Yes.

Q. It's not a difficult problem, if (p. 252) people have representatives in this state soliciting orders, is it?

A. No.

Q. In fact, there is—the statute of the State of Texas says that's nexus?

A. That's right.

MR. MENDEZ: Your Honor, if I may? You're making me real nervous standing here. I don't think under the local rules—

MR. GEORGE: I'll be happy to sit down. I was going to approach the board here in a minute.

QUESTIONS BY MR. GEORGE:

Q. In addition the case law says that's perfectly within the Constitution of the United States, doesn't it?

A. That's right.

Q. You're a lawyer and very familiar with these issues?

A. That's correct.

Q. And you subscribe to magazines?

A. Yes, I do.

Q. And you subscribe to out of state magazines?

(p. 253) A. Yes.

Q. Which ones?

A. *International Living.*

Q. Where is that published?

A. New Jersey or someplace like that. I don't really remember.

Q. All right. Anything else?

A. *Islands.*

Q. Where is that published?

A. A little fantasy time here, I think. Also out of state. I don't remember. *Texas Monthly,* you'll be glad to hear.

Q. Mr. Levy will be particularly glad to hear that.

A. And *TV Guide,* and I think at present those are the only magazines I subscribe to.

Q. Do you pay use taxes on those out of state subscriptions?

A. I have no idea whether I'm paying a use tax or not. It is not specified.

Q. Do you remit it on out of state magazines that are mailed to you?

A. No.

Q. And you know that's—

A. I don't fill out a use tax form and (p. 254) send it in.

Q. You understand that's the general practice in this state?

A. I believe that, you know, it would probably be the case but I don't know.

Q. And let me ask you are you aware that at the time this statute became effective involving the taxes on magazine subscription sales that the Comptroller's office, Mr. Castlebury—Mr. Castlebury is senior official in the Comptroller's office, is he not, sir?

A. He is Associate Deputy Comptroller. He is senior official, yes.

Q. And he was supplied with the knowledge that people had—that magazine publishers from out of state had folks coming in the state soliciting orders through school agents. Do you know that?

A. The—from what I understand with conversations with Mr. Castlebury is that it becomes a very interesting question as to who is soliciting for whom, and it is probably a very delicate constitutional question when you have a —what I would call a daisy chain situation. Like I say, it's been described to me a magazine will (p. 255) employ Publishers Clearinghouse or ask for names, as they call

it, who will then go to brokers, who will then go to other parties, and you may have a whole series of parties involved before the little Girl Scout or the guy working his way through college comes to the door.

Q. You understand that if somebody takes an order for a publisher in this state, under the statutes of this state and under a Scripto case out of Florida—if an independent contractor or any employee or anybody else takes orders, that's within the power of the State to tax that—those people as doing business?

A. I would argue—I consider that a close constitutional question. I would basically agree with you, however, in that I think that that is probably going to be tested, and hopefully, you know, we will find an answer to that question out.

Q. You think that's a close question? Is that your testimony?

A. I think that is a close constitutional question, yes, sir.

Q. In connection with the people who come into this state soliciting orders for all (p. 256) kinds of machinery and other things of that nature, you claim those people are doing business in Texas, don't you?

A. In most instances those are directly tied the way you have—the way I understand your example—to the manufacturer. Now, when you start putting intermediaries between the person making the sale, then you have, you know, questions that are raired.

Q. Mr. Anderson, you know that it is common practice in the electronics industry. It is common practice in al-

most every modern industry to have what you call sales representatives, people, independent contractors who peddle multiple lines of electronic goods that come through the states taking orders for those goods. You know that, and you know that that's treated as doing business in this state, whether those people are independent contractors working for themselves or employed by some other organization, and you treat them as doing business in this state, and you have a different rule for magazines. That's right—

A. It is my understanding—it is my understanding that that is not what we do— (p. 257) that if they—there are layers between the salesmen and the company ultimately making the sale. I don't believe at this time we have been picking up those sales between—not for magazines but for any sale of goods. Now, that may or may not be correct. As far as our policy, I think you've had other people testifying on that, but that's my understanding of the policy.

Q. It's the legal position of the State of Texas that if there is a non-employee—a person—

A. No, I'm not going to take that as legal position. What I'm saying is our present position is that we have not picked up facts in that instance where there have been intermediaries between the seller and the ultimate salesmen. That is our—what we have done presently.

Q. That's what you're doing?

A. That is what we're doing for everyone—not just magazines but for everyone, and what I'm saying is that may or may not be correct, and maybe we should be proceeding against the other intermediary.

Q. Well, you do that intentionally? (p. 258) You take that policy and made that decision and are intending to do it that way?

A. Because we consider that with intermediaries you have a constitutional question, yes, sir, that is correct.

Q. There isn't any case law to support that position, is there, Mr. Anderson?

A. If there is real good case law to support the position that it was not, we would probably pick it up. Now, you have the Scripto case, of course—

Q. Which is directly on—

A. —which is an independent contractor situation, but you don't have in the Scripto, as I recall—it's been a while since I've read Scripto truthfully, but as I recall that was not a situation where you had layers of people between the company making the sale and the independent contractor.

Q. If I am a company that contracts to sell *Reader's Digest* subscriptions and I hire people to go into there, and your position is that I am not—those people don't have any relationship with *Reader's Digest* or relationship with their employer, and they take (p. 259) orders. They're not—*Reader's Digest* is not doing business in this state?

A. My position is that they may well be doing business, but we have not gone to the layered—we have not gone into the layering situation.

Q. Now, as I understand it, there is no concerted effort made by the Comptroller's office in any form to

try to encourage voluntary compliance by non-business taxpayers to pay their use tax?

A. I'm sorry. I just didn't really hear your question very well.

Q. As I understand it, there is no organized policy by the Comptroller's office to encourage voluntary compliance with a use tax obligation of non-business users of out of state products; is that right?

A. I think we put out brochures advising people of their use tax obligation, but as far as I know, that would be about the limit of our—any program that we might have.

Q. Yes, sir, and you had a study done, and about—what—a hundred and forty-five million dollars a year is being—

(p. 260) A. It varies to a hundred and forty-five.

Q. A hundred and thirty to a hundred and forty-five million dollars a year being lost for not collecting use taxes that are owed; is that right?

A. Not being able to economically collect use taxes that are owed, yes.

Q. Now, that's what you're not collecting—a hundred and thirty to a hundred and forty million dollars?

A. That's probably right.

Q. And you have done absolutely no studies and no work on how one could encourage some voluntary compliance to pick up some of the money from the people who owe the money, which are the users of those products?

A. I cannot tell you that nothing has been done in that area because the Comptroller's office is a big office, and people may have done some things that I'm unaware of. I'm unaware of any program, as you describe, other than simply letting the public know that use tax is due on the items purchased from out of state, and we have done publicity on that is my understanding.

(p. 261) Q. But, Mr. Anderson—

A. In answer to your question, I'm unaware of any program, as you describe it.

Q. Mr. Anderson, there is lots of money out there to be collected, isn't there?

A. Yes, there is.

Q. And you understand that we have all kinds of voluntary rendering systems of paying taxes in Texas. Ad valorem taxes are voluntarily rendered. It used to be taxes on intangibles were voluntarily rendered. That's tradition in this state, isn't it?

A. Well—

Q. You as a lawyer know that?

A. Yes, and you have different degrees of success in those programs, as well.

Q. Yes, sir, and those programs have been used, and enforcement encourages compliance?

A. Sure.

Q. Highly visible enforcement is taken by your—

A. You know, voluntary—any tax program has to operate through voluntary compliance.

Q. Yes, sir, and, Mr. Anderson, you (p. 262) know that your company—your company—the Comptroller's office goes out and enforces the tax obligation against one particular taxpayer spending a lot more money with your raids and other things that you have done in the past on noncomplying taxpayers, although you may not get all of the money from that one collection. So you get publicity that you're out enforcing it, and you do that to encourage other people to pay their taxes?

A. That's right.

Q. And you haven't tried that one time? You haven't taken the newspaper reporters and everybody and gone down to pick somebody—I saw in the paper the other day that the Governor's wife bought a coat in New York—gone down to Governor White's office and found out if she paid her sales tax. You would have probably got a lot of publicity on the obligation to pay taxes then, wouldn't you?

A. Well, that's—I'll have to pass that along to Mr. Bullock. We, of course, do go after large items that are purchased by individuals.

Q. By businesses?

(p. 263) A. No, not businesses—large items purchased by individuals where we can identify them but you've got—

Q. Airplanes and boats?

A. Airplanes and boats, but you've got two things that make that possible. One, the dollars involved make it economically possible, and two, you've got a record as to

who has purchased the item. It is—for instance, let's—if we wanted to go after a magazine, let's say, or let's say J. Bean—J. Bean?

Q. L. L. Bean?

A. L. L. Bean. Close. All right. L. L. Bean.

Q. When you buy your island, you might want to—

A. All right. Might need some of that. If we wanted to go to L. L. Bean and said, "All right. We want to know everybody that has purchased items in Texas so we can—we know we can't require you to do that because you don't have any nexus, but we want to see the records of all of the people that purchased items from L. L. Bean so we can go to each one of those and say, 'You know, pay us the $2 in tax, the $1 in (p. 264) tax, the $5 in tax or whatever it happens to be,' " L. L. Bean would simply refuse to make their records open to us.

Q. What I'm asking you, sir, is you have testified that you don't think it would be economical to try to collect the tax from regular consumers, non-business use tax obligees?

A. All right. That's correct.

Q. You don't think that?

A. I don't think that.

Q. And the question—and you have made, however, no studies of what you could do. You have made no efforts to try it and see what happened. You have done absolutely nothing, except we've come to the conclusion that you don't

think it could work under any circumstances. Isn't that the facts, Mr. Anderson?

A. Other than just general advertising, I think that is basically true.

Q. All right, and isn't it also true that the Legislature passed this tax obligation on you and me making us obligated to pay the use tax on the magazines—*Island* magazine and *International Lifestyle* and whatever I subscribe (p. 265) to, and your department of government is obligated to enforce that tax, whether you think it's a good idea or not?

A. Well, I don't think that the Legislature would contemplate us trying to spend, you know, $5 to collect 50 cents.

Q. I understand that, but don't you need to go out and try to see what you could do before you just write it all off—write that hundred and forty-five million dollars off and say, "Congress, help me"?

A. Well, quite frankly, other than advertising through brochures and letting people know that there is an—you know, a liability, quite frankly I don't know what else you'd do.

Q. How about some enforcement actions that's all publicized? Go to somebody's—go to Judge Dibrell's house and see if he bought anything.

A. Let's say that we did go ahead and go to Mark White's wife and say, "Did you pay tax on that?" and she says, "Sure did," or "Sure didn't"—one or the other and—but let's say that she didn't. She may well have

done so, but what—how much enforcement would you get out (p. 266) of that for someone who had purchased an item in Oklahoma while they were on vacation or purchased something while they were—through a mail-order house that was $5? Do you really expect that they would go to the trouble or be so afraid of the Comptroller's office coming after them for $5 in tax that they would fill out a use tax return and send it in to us? I personally don't believe that would happen, but that is merely a belief on my part.

Q. Do you know that, in fact, people— sometimes there are some citizens of this state that come in and bring you a check because they know that's their obligation, and they pay it. They don't have to fill out any form. There's no form required. There's nothing required except putting the money in the bank?

A. I have worked for the Comptroller's office for about 20 years and I'm not saying I haven't seen it, but I could probably count those instances on one hand that I have.

Q. But it can be done?

A. It could be done, but it's not a practical way of collecting the money.

Q. But if you encourage people to (p. 267) comply —simply tried once to tell people through enforcement actions that that's their obligation—I mean, when I get one speeding ticket, it affects me and my wife and my 17-year-old son and everybody in my household.

A. Well, of course, following that line of reasoning, we do exactly that with boats and airplanes. You know,

when the guy has bought the boat or the airplane and brought it into Texas, it does exactly what you're asking us to do with the Governor's wife.

Q. You haven't done anything to get publicity for it. You don't have a general campaign. You simply write off the hundred and forty-five million dollars and go to Congress. That's what's happening, isn't it?

A. All right. If what you're saying—we write off the hundred and forty million or thirty million—whatever it is—in the sense that we don't start a campaign to get everybody to report every cent they owe in terms of, you know, the hundred and fifty dollar tent that somebody buys and has mailed into them or the $10, you know, Walkman, you know, I can't say that we'd make a great effort to do that, but I (p. 268) don't believe that it would bring in just much money, but there again you're talking about a belief, and I can merely tell you what we've done.

MR. GEORGE: Pass the witness.

MR. MENDEZ: No questions.

THE COURT: You may step down, sir.

THE WITNESS: Thank you.

MR. MENDEZ: We'll call Mr. Harold Lee. I understand we've called our last witness up—he was on call—on the phone, you know, and he's on his way over here, and I'll try to be as brief as possible. I just want to build this record on this one point.

THE COURT: All right, sir. You've been previously sworn, haven't you?

THE WITNESS: Yes.

HAROLD LEE

was recalled as a witness and, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

(p. 269) QUESTIONS BY MR. MENDEZ:

Q. Mr. Lee, you've testified about some things that Audit Division might not have done when Mr. George called you earlier. I'd like for you now to explain to Your Honor a little bit about what the Audit Division does. How many people does the Audit Division have right now?

A. The Audit Division has slightly over 700 people.

Q. Okay, and where are these people located?

A. Our personnel are located nationwide to a degree. We have 21 offices throughout Texas and the nation. There's four offices located outside of Texas and 17 offices located in Texas. Of our 700 plus people, there's 70 of those personnel in our out of state offices and the remainder in our Texas based offices. Out of this 700 plus people, there are about 30 people in our audit headquarters which are support personnel. Within the 700 total people, there are 525 auditors, 46 audit group supervisors, 21 audit managers, approximately 25 audit technicians, who assist auditors in (p. 270) conducting audits, 70 some-odd administrative personnel.

Q. Okay, sir, and you use—well, what are the function of all of these auditors that are out there? What do they do for this office?

A. The primary function for the auditors is to audit businesses doing business in Texas for the various taxes

administered by the Comptroller's office, of which there's approximately 30.

Q. Okay, sir, and could you give the Court an idea of how many audits that group does during the period of a year?

A. In fiscal 1985 we did approximately 23,000 audits. In this fiscal year 1986 we plan on doing somewhere in the neighborhood of 25,000, 26,000 audits.

Q. Okay, sir, and about how much revenue did those audits generate last year?

A. Last year we generated assessment somewhere in the neighborhood of 280 million dollars.

Q. Okay, sir, and could you explain for the Court briefly the audit select systems that you may have in place so that these auditors can (p. 271) be used effectively?

A. The sales tax on a select system deals a lot with protecting the tax base we have. The first thing we look at or the first accounts we look at are approximately 46 to 4700 accounts that pay 65 percent of the total revenue—sales tax revenue to the State each year. These 4600-plus accounts are audited every four years, which is our statute of limitations. There are a few counts [sic] that come in and go off at the lower end of the 65 percent. We run a new list every six months on this, and it is provided to the audit offices for them to work from and select accounts.

We—I'll go back and say we have some centralized audit select, and then a lot of the audit select is decentral-

Section 151.312 violates all three prongs of the *Lemon* test and is plainly unlawful.

CONCLUSION

The judgment of the Texas Court of Appeals should be reversed and the judgment of the district court affirmed.

Respectfully submitted,

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